United States Court of Appeals

FOR THE SECOND CIRCUIT

In the Matters

of

THIRD AVENUE TRANSIT CORPORATION, SURFACE TRANSPORTATION CORPORATION OF NEW YORK, WESTCHESTER STREET TRANSPORTATION COMPANY, INC., THE WESTCHESTER ELECTRIC RAILROAD COMPANY, WAKONTAS PRESS, INC.,

Debtors,

JOHNSON FARE BOX COMPANY,

Claimant-Appellant,

SURFACE TRANSPORTATION CORPORATION OF NEW YORK and THIRD AVENUE TRANSIT CORPORATION,

Appellees.

Docket Bankruptcy No. 85851

APPENDIX TO APPELLANT'S BRIEF

On Appeal from the United States District Court for the Southern District of New York

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United States Court of Appeals

FOR THE SECOND CIRCUIT

In the Matters *of* Third Avenue Transit Corporation, Surface Transportation Corporation of New York, Westchester Street Transportation Company, Inc., The Westchester Electric Railroad Company, Warontas Press, Inc. Debtors.	Bankruptcy No. 85851 Johnson Fare Box Company, Claimant

Statement Under Rule 15(b).

Between February 7, 1949 and June 10, 1949, the debtor, Surface Transportation Corporation, purchased 225 new fare boxes from Johnson Fare Box Company for $55,959.84, of which there was paid $12,426.00, leaving a balance unpaid of $43,533.84. The appellant, Johnson Fare Box Company submitted an Amended Proof of Claim, dated January 21, 1952, asking priority for the amount of its claim. The Trustee classified the claim as a non-priority claim.

The matter came on for hearing on October 22, 1956. Honorable Edward J. Dimock, in a memorandum order filed March 15, 1957, classified the liability to the extent of $42.84 as a six months' claim. He denied classification of the balance i. e. $43,491.00 as a six months' claim.

Upon stipulation and order of the Court, dated May 7, 1957, the time to file a notice of appeal was extended to May 10, 1957. Upon stipulation and order of the Court, the time to docket and file the record on appeal was extended to July 15, 1957.

Exhibit 2 on the Hearing Dated October 22, 1956, Before Dimock, J.

Amended Proof of Claim.

STATE OF ILLINOIS }
COUNTY OF COOK } ss.:

P. E. GANZ of Chicago, County of Cook, State of Illinois, being duly sworn, deposes and says:

1. That he is the Vice President of Johnson Fare Box Company, a corporation organized and existing under the laws of the State of Delaware, and carrying on business at No. 4619 Ravenswood Avenue, in Chicago, County of Cook, State of Illinois, and is duly authorized to make this proof of claim on its behalf.

2. That Third Avenue Transit Corporation and Surface Transportation Corporation of New York, debtors herein, were at, before and after the filing against them of a petition for reorganization, and still are, justly and truly, indebted to said corporation in the sum of $43,728.05.

3. That the consideration of said debt is as follows: Necessary fare boxes and parts furnished by Johnson Fare Box Company to Third Avenue Transit Corporation and Surface Transportation Corporation of New York, a detailed statement of which is attached hereto and made a part hereof by incorporation and reference as Schedule "A".

4. That no part of said debt has been paid.

5. That there are no set-offs or counter-claims to said debt.

6. That said corporation does not hold, and has not, nor has any person by its order, or to deponent's knowledge, or belief, for its use, had or received, any security or securities for said debt.

Exhibit 2 on the Hearing Dated October 22, 1956, Before Dimock, J.

7. That no note or other negotiable instrument has been received for such account or any part thereof and that no judgment has been rendered thereon.

8. Deponent further says that the necessary operating equipment described in said Schedule "A" was delivered on and after June 30, 1948 and within six months prior to the filing of the petition for reorganization filed herein; and said equipment was delivered within six months prior to the filing of the amended petition for reorganization filed herein; that said equipment being necessary for the continued operation of the debtor, the debt due to Johnson Fare Box Company is entitled to priority in the time of payment over all first mortgage bond holders, adjustment income mortgage bond holders, all general creditors (except general creditors furnishing necessary equipment within six months prior to October 25, 1948, who are in the same class as this claimant) and all shareholders.

9. In addition to the claim based upon the six months' rule, the claimant further states that for a period of about eight months after the original filing of the petition and until June 21, 1949, the debtors, with the full knowledge and consent of the Court and all parties in interest, including the representatives of the respective classes of creditors, the City of New York, the Securities & Exchange Commission, and the Public Service Commission, were operating their properties in the ordinary course of business, including the purchase of the fare boxes here involved, and were in fact "in possession of" said properties. No request for the appointment of a Receiver was made until June, 1949, and even as late as June 10, 1949 the Court by order refused to appoint a Receiver but merely enjoined the debtors from engaging in "transactions not in the ordinary course of business". By said

Exhibit 2 on the Hearing Dated October 22, 1956, Before Dimock, J.

order, the Court implicitly ratified transactions prior to June 10, 1949 which *had been* in the ordinary course of business. The purchase by the debtors of the fare boxes was necessary to preserve the estate and was in the nature of "administration expenses". In view of the circumstances above stated, and since the fare boxes became a part of the property subject to the first mortgage, thus enriching the estate of the first mortgagee and the debtors without consideration, the claimant should have a priority for the amount of its claim.

P. E. Ganz,
Vice President, Johnson Fare Box Company,
Claimant.

Subscribed and sworn to before me this 21st day of January, 1952.

Mary Stritar,
Notary Public.

(Seal)

Schedule "A."

Necessary Operating Equipment, viz.: Fare Boxes and Parts furnished by JOHNSON FARE BOX COMPANY to THIRD AVENUE TRANSIT CORPORATION:

Date of Invoice	*Amount*
6/30/48	$ 278.76
7/ 7/48	282.05
7/13/48	141.24
7/16/48	7.34
7/21/48	83.68
7/23/48	33.39
8/10/48	20.17
8/17/48	390.55
8/17/48	561.26
8/25/48	53.52
8/31/48	16.03
9/ 2/48	99.66
9/ 8/48	91.82
9/17/48	97.64
9/21/48	68.22
10/ 7/48	82.62
10/ 7/48	163.26
10/13/48	52.46
10/21/48	7.34
10/28/48	72.04
11/ 4/48	141.24
11/ 4/48	46.33
11/ 4/48	141.24
11/ 5/48	79.99
11/12/48	76.19
11/17/48	274.99
11/18/48	78.87
12/23/48	289.82
12/31/48	11.98

Schedule "A".

Date of Invoice	*Amount*
1/20/49	$18.54
2/18/49	53.15
4/ 8/49	18.31
5/ 3/49	108.07
6/22/49	16.91
Total	$3,958.09

Necessary Operating Equipment, viz.: Fare Boxes and Parts furnished by JOHNSON FARE BOX COMPANY to SURFACE TRANSPORTATION CORPORATION:

Date of Invoice	*Amount*
2/ 7/49	$ 42.84
3/18/49	3,727.80
3/21/49	3,727.80
3/22/49	4,970.40
4/15/49	6,213.00
4/19/49	6,213.00
4/20/49	2,733.72
4/21/49	1,242.60
4/29/51	2,485.20
4/27/49	2,485.20
4/29/49	3,479.28
5/24/49	1,491.12
5/25/49	2,485.20
5/26/49	4,970.40
5/27/49	3,479.28
6/10/49	6,213.00
Total	$55,959.84
GRAND TOTAL	$59,917.93

Schedule "A".

PAYMENTS

THIRD AVENUE TRANSIT CORPORATION:

Date	*Amount*
11/30/48	$ 817.37
12/ 1/48	475.56
12/ 2/48	78.42
12/ 9/48	715.83
1/ 3/49	213.18
1/12/49	289.13
2/10/49	706.98
2/28/49	301.81
3/ 9/49	2.83
4/ 1/49	18.30
5/16/49	144.47
Total	$3,763.88

SURFACE TRANSPORTATION CORPORATION:

Date	*Amount*	
6/ 1/49	$12,426.00	
TOTAL PAYMENTS		$16,189.88

RECAPITULATION

Total shipments	$59,917.93	
Total payments	16,189.88	
Balance due		$43,728.05

Stipulation as to Facts.

(244)

IT IS HEREBY STIPULATED that the following statements of fact are true and that the documents hereinafter referred to may be admitted in evidence as exhibits upon the hearing without further identification, this stipulation being made solely for the purposes of this proceeding and both parties reserving all rights to object to the relevancy or materiality of any matters stated or documents referred to herein.

1. During the year 1949, the debtor, Third Avenue Transit Corporation (hereinafter called "Third Avenue") and its wholly owned subsidiaries (including Surface Transportation Corp., hereinafter called "Surface") operated a public transportation system with busses and street cars in the Boroughs of Manhattan and the Bronx, and the County of Westchester. Its operation required about 981 busses and 84 street cars to carry passengers over 68 bus lines with a total route mileage of approximately 331 miles, and 12 trolley routes with a total route mileage of 36 miles. On (245) many days over 1,000,000 revenue passengers were carried.

2. During the years 1948, 1949, and 1950, the total revenue passengers carried were as follows: 1948, 420,000,000; 1949, 355,021,901; 1950, 309,606,799.

3. On or about December 20 1911, Third Avenue Railway Co. made and delivered to Central Trust Company of New York as Trustee for the holders of First Refunding Mortgage Gold Bonds a certain first refunding mortgage (hereinafter referred to as the Trust Indenture) which covered real and personal property of Third Avenue Railway Co. as described therein and which was thereafter duly recorded as provided by law. A copy of said

mortgage is annexed hereto, marked Exhibit A, and made a part thereof.

4. On or about July 1, 1942, Third Avenue was formed by the merger and consolidation of Third Avenue Railway Co. with certain other corporations, and Third Avenue thereupon succeeded to the rights and became subject to the liabilities of Third Avenue Railway Co. under the Trust Indenture.

5. The Trust Indenture in the years 1946 to the present time was and still is in full force and effect as security for the said First Refunding Mortgage Gold Bonds issued by Third Avenue Railway Co. and therefore assumed by Third Avenue outstanding in the hands of the public in said years in the aggregate amount of about $15,000,000.

6. During the years 1948 to 1949, the Central Hanover Bank and Trust Company (now called the "Hanover Bank") succeeded Central Trust Company of New York as Indenture Trustee, and in said years was and is still duly acting as such thereunder.

7. An additional mortgage was executed by Surface to the Indenture Trustee dated March 9, 1942, and was duly recorded. A copy thereof is annexed hereto, marked (246) Exhibit B, and made a part hereof.

8. A still further additional mortgage dated March 9, 1942 was executed and delivered by Surface to Chemical Bank and Trust Company as Trustee. A copy thereof is annexed hereto, marked Exhibit C, and made a part hereof.

9. Third Avenue, or its predecessor, and Surface have been purchasing fare boxes and parts therefor from Johnson since at least the year 1936.

Stipulation as to Facts.

10. From January 1, 1940, the terms of payment for such sales have always been on the basis of thirty days net and 1% discount if payment were made within ten days, and prior thereto, the discount was 2%.

11. On June 21, 1949, the United States District Court for the Southern District of New York entered an order directing the appointment of Trustees for Third Avenue and its subsidiaries.

12. On December 23, 1948, Johnson shipped and invoiced to Third Avenue parts for fare boxes in the amount of $289.83; on December 31, 1948 in the amount of $11.98; on January 20, 1949 in the amount of $18.54; on February 18, 1949 in the amount of $53.15; on April 8, 1949 in the amount of $18.31; on May 3, 1949 in the amount of $108.07; and on June 22, 1949 in the amount of $16.91, or a total amount of $516.79. All of said invoices have been paid except invoices totaling $194.21, which still remain unpaid.

13. Johnson shipped and invoiced to Surface fare boxes on the following dates and in the following amounts:

Date	*Amount*
2/ 7/49	$ 42.84
3/18/49	3,727.80
3/21/49	3,727.80
3/22/49	4,970.40
4/15/49	6,213.00
4/19/49	6,213.00
4/20/49	2,733.72
4/21/49	1,242.60
4/26/51	2,485.20
4/27/49	2,485.20
(247) 4/29/49	3,479.28
5/24/49	1,491.12

Date	*Amount*
5/25/49	2,485.20
5/26/49	4,970.40
5/27/49	3,479.28
6/10/49	6,213.00

The aggregate amount of such purchases was $55,959.84, of which there was paid $12,426, leaving a balance unpaid of $43,533.84.

14. Until on or about September 22, 1948, the fare upon the busses of Third Avenue and Surface was 5 cents.

15. Prior to the institution of a fare higher than 5 cents, all busses operated by Surface were equipped with a so-called "J" type of fare box. These boxes were so constructed that a nickel inserted therein would register as one fare and a dime as two fares.

16. From November 28, 1948 a 7¢ fare was instituted on said busses. When such increased fare was instituted, a tray was provided for each bus upon which the passenger dropped two pennies and inserted a nickel in the fare box. Accordingly, at the end of each day's run, the bus operator was required to turn in to Surface 7¢ for each fare registered on the box. Due to unfamiliarity or thoughtlessness on the part of passengers, a certain percentage of passengers would insert the total fare in the box which then registered five fares, since a penny registered two fares, as did a dime. As a result, Division Superintendents of Surface were authorized to refund to the bus operators the amounts erroneously registered, provided the bus operator made a claim and signed an appropriate refund slip.

17. In order to offset the inevitable increase in the number of fares registered in the box by such insertion

of peanies, many bus operators adopted the practice of taking certain fares "over the box" instead of having the fares inserted in the box. In the course of several months, as a result of investigations by Inspectors of (248) Surface, a number of bus operators were suspended for this practice. The Union representing the operators protested to the management of Third Avenue and its subsidiaries that the basic cause of this trouble was the failure of the Companies to provide proper fare collection devices.

18. Third Avenue and Surface also recognized that the method of collecting the pennies in a tray imposed an additional burden on the bus operators and also slowed down the entrance of passengers into the busses.

19. Consequently Third Avenue and Surface made, a survey of the market for the most practical fare box equipment for the collection of fares involving more than one coin. They found that the Johnson fare box was the most suitable box and that it was used by the Board of Transportation in the City of New York and other privately owned bus lines in this city.

20. On February 8, 1949, as a result of such survey, Surface placed an order with Johnson for 450 fare boxes at a cost of $228 per box, plus 7% federal tax and 2% New York City sales tax if boxes were delivered for use in the City of New York.

21. At the time such order was given to Johnson, Third Avenue and its subsidiaries were using 400 of this type of fare box which had been borrowed from the City of New York for use on their lines where combination subway-bus tickets were being sold.

22. The delivery of said fare boxes was as shown in paragraph 13 above.

23. All of said fare boxes so ordered and delivered were intended for use and were used on old busses then in use as replacements for the previously used "J" boxes.

24. Following the appointment of the Trustees of (249) Third Avenue and its subsidiaries, the Trustees brought a petition dated September 2, 1949, for leave to purchase 334 additional fare boxes for Surface and 115 additional fare boxes for Debtor, Westchester Street Transportation Company, Inc. Said petition was granted by order dated September 8, 1949, and a copy thereof is annexed hereto, marked Exhibit D, and made a part hereof.

25. The fare boxes delivered prior to June 21, 1949 were for the purpose of immediate use, and not to "provide an adequate margin of reserve for boxes out of order."

26. As stated by the affidavit in support of said petition, "the need for additional boxes had been further accentuated by the recent purchase of 25 new busses by Surface for use in the City of New York" (prior to the date of the petition).

27. Johnson refused to grant Third Avenue and Surface credit for payment of said 450 fare boxes, except as stated in paragraph 10, although the same was requested on behalf of the Debtor and/or Surface.

28. The liability for payment for said boxes was a current liability of Third Avenue and/or Surface, and said claim represented a debt contracted with the expectation or intention of Johnson that it was to be paid out of the current earnings of Third Avenue and/or Surface.

29. The fare boxes so ordered and delivered were intended for and were used in the ordinary operations of the Debtor and Surface.

Stipulation as to Facts.

30. The original petition for reorganization was an involuntary one filed by creditors on October 25, 1948. Subsequently, leave to serve and file an amended petition was obtained by the petitioning creditors and was filed on or about December 7, 1948.

(250) 31. On June 20 or June 21, 1949, Third Avenue itself filed what was designated as a "Petition and Consent", which document is incorporated herein by reference.

32. On June 21, 1949 the Court entered an order directing the appointment of the Trustees, which order is incorporated herein by reference.

33. Throughout this period of eight months (since the filing of the original Petition for Reorganization) the Debtors had been under the jurisdiction of the Court. The City of New York, the Public Service Commission, The Securities & Exchange Commission, and the Court itself were fundamentally interested in the preservation of the rights of the public and/or the creditors. Throughout this period the Debtors were permitted by these bodies to continue their operations. No Receiver of Third Avenue or Surface was appointed, nor, in fact, was any application ever made for such appointment until June, 1949. After the Court was requested by the Securities & Exchange Commission in June, 1949, to appoint a Receiver, the Court refused to do so. In its order dated June 10, 1949, denying the petition for a Receiver, the Court restrained the Debtors (pending the proceedings before the Referee on the issue of their insolvency) from engaging in "any actions not in the ordinary course of business."

34. The Trustee's Proposed Plan of Reorganization describes the treatment of "six months claims" as preferred claims and describes such claims in Article I as follows:

> "Six months claims: All claims, as defined, which are entitled to priority consisting mainly of claims

for current expenses of ordinary operations incurred by the debtors without the extension of long term credit and within six months prior to the appointment of the Trustee in reorganization proceedings."

35. The following appears on page 99 of the Trustees' Report and Notice pursuant to Section 167, sub-(251) divisions 5 and 6 of Chapter X of the Bankruptcy Act. It is part of a note to the financial statements in the Section 167 Report and is as follows:

"Since Third Avenue Transit Corporation and subsidiary companies are operated to a considerable degree as a system rather than as individual companies expenditures may be made in the first instance by one company for the benefit of another or other companies. This practice has continued, and subsequent to June 21, 1949, the trustees of the various companies have made additional advances to affiliated companies or have reduced amounts previously so advanced."

Dated: October 17, 1956.

SAXE, BACON & O'SHEA
Attorneys for Trustees

LORENZ, FINN & GIARDINO
Attorneys for Johnson
Fare Box Company

Stipulation as to Facts.

Statement with respect to Exhibit mentioned in the Stipulation as to Facts, which is set forth at pages 8a to 15a herein.

Exhibit A, referred to in said Stipulation as to Facts contains, among other provisions, the following:

"NOW, THEREFORE, THIS INDENTURE WITNESSETH:

That in order to secure the payment of the principal and interest of all said bonds at any time issued and outstanding under this indenture, according to their tenor, purport and effect, and to secure the performance of observance of all the covenants and conditions upon which such bonds are issued, received and held, and for and in consideration of the premises and of the acceptance or purchase of said bonds by the holders thereof, * * * the said THIRD AVENUE RAILWAY COMPANY, the party of the first part, has granted, bargained, sold, released, assigned, transferred and conveyed unto said CENTRAL TRUST COMPANY OF NEW YORK as Trustee, the party of the second part, its successors and assigns forever, all and singular its property, real and personal of every nature and description whatsoever, and wheresoever situated, including the following: * * *

Also any and all lines of railroad, extensions and branches, lands and improvements of any description, machinery, cars and other equipment, stock, bonds, notes and other obligations and other property of any description whatsoever, which the Railway Company may acquire by the use of bonds, or the proceeds of bonds reserved under subdivision (3) of Article Second of this indenture, or with the proceeds of any

property mortgaged or pledged hereunder, or otherwise acquired under the provisions of this indenture;

Together with all and singular the improvements thereon * * * and other rights or interests now owned or at any time hereafter acquired by the Railway Company, for use upon or in connection with any of the above described lines of railway or property or any other line of railway, extension or branch or other property now or hereafter subject to the lien of this indenture; * * * and all dynamos, belting, engines, boilers, regulators, meters, poles, trolleys, ducts, conduits, feeders, cables, wires, switch boards, lamps and machinery for producing, generating or distributing electricity or power, and also all and singular the rolling stock, equipment, motors, engines, tenders, carriages, cars, trucks, horses, harness, tools, implements, furniture, fixtures, machinery, material, coal, wood, oil, fuel, and other supplies * * * now owned or hereafter acquired by the Railway Company for use upon or in connection with any line of railway, branch, extension or other property now or hereafter subject to the lien of this indenture; all of which personal property is hereby declared to be fixtures and appurtenances of said railroads.

Together with the tools, chattels, machinery, motors, engines and equipment of every description located in or upon the said lands and buildings or elsewhere or kept or used in connection therewith for the generation, conversion, transformation or transmission of electrical power or light or for any other purpose connected with the maintenance or operation of the above described railways or any of them, including all cables, wires, ducts, and conduits and their appurtenances for the transmission of alternating current from said prop-

erty to other power houses or sub-stations, * * * together with all and singular the tenements, hereditaments and appurtenances belonging to or in anywise appertaining to any line of railway, extension, branch or other property or properties now or hereafter subject to the lien of this indenture. * * *

Also all property of every name and nature hereafter, by delivery or by writing of any kind, for the purposes hereof pledged, assigned or transferred by the Railway Company or, with its written consent, by any one in its behalf to the Trustee, which hereby is authorized to receive any property as and for additional security, and also, when and as hereinafter provided, as substituted security, for the payment of the bonds issued or to be issued hereunder, and to hold and apply any and all such property according to the terms hereof.

And also all and singular the tolls, fares, rents, issues, dividends, interest, earnings, income, profits and other benefits and advantages of, or in any wise growing out of, all or any of the said several railroads, franchises or properties, now or hereafter subject to the lien of this indenture. * * *

The Railway Company at all times will maintain, preserve and keep or cause to be maintained, preserved and kept, the mortgaged property and the property of all Controlled Companies, and every part thereof, with the rolling stock, fixtures and appurtenances, and every part and parcel thereof, whether owned, leased or operated by it, in thorough repair, working order and condition, and supplied with motive power, rolling stock, equipment, materials and supplies, and from time to time it will make or cause to be made,

all needful and proper repairs, renewals, replacements, additions, betterments and improvements thereto, so that the traffic and business of every part thereof shall at all times be conducted with safety and expedition. * * *

Unless and until, according to the provisions of Article Fourth hereof, the Trustee shall have become entitled to enter into possession of the mortgaged premises, the Railway Company shall be entitled to collect, receive and use, in its discretion, all dividends, interest and income now or hereafter payable upon all shares of stock, bonds, notes, and other obligations now or hereafter subject to this indenture. * * * The Trustee, in case of such entry (in the event of default) shall have the right to manage the mortgaged railroads, franchises and property, and to carry on the business and to exercise all the rights and powers of the Railway Company, either in the name of the Railway Company or otherwise, as the Trustee shall deem best; and it shall be entitled to collect and receive all tolls, fares, earnings, income, rents, interest, dividends, issues and profits of the mortgaged railroads, franchises and property and every part thereof, including the dividends upon all shares of stock and the interest upon all bonds, notes and other obligations subject to the lien of this indenture. After deducting the expenses of operating said railroads, franchises and property, and of conducting the business thereof and of all pairs, maintenance, renewals, replacements, alterations, additions, betterments and improvements, * * * the Trustee shall apply the moneys arising as aforesaid as follows:" (to the payment of principal and interest of bonds in default)

Stipulation as to Facts.

"Unless the proceeds of sale of any such property" (in the event of default) "shall be payable to the Trustee under said First Mortgage of The Third Avenue Railroad Company, or unless some other disposition of said proceeds be required either by reason of said mortgage or by reason of some other prior lien on the property sold, the proceeds of any such sale, * * * shall be received and set apart by the Trustee, * * *" (for certain described purposes) "or to pay for additions or betterments or improvements of the mortgaged railroads, franchises or property, or to the purchase of equipment for use thereon, which additions, betterments, improvement and equipment shall likewise be subjected to the lien of this indenture, or to reimburse the Railway Company for expenditures certified in writing by its treasurer or assistant treasurer to have been made by it for said purposes or any of them."

Exhibit "D" Annexed to Stipulation as to Facts and Exhibit 3 at Hearing Dated October 22, 1956.

Notice of Motion of Trustees for Order Authorizing Payment for 25 Fareboxes Purchased and Purchase of 449 Additional Fareboxes From Johnson Farebox Company.

(1)

SIRS:

TAKE NOTICE, that on the annexed petition of I. Howard Lehman, Lester T. Doyle, and James Hodes, verified September 1, 1949, the undersigned will move this Court at a hearing to be held in Room 506, United States Court House, Foley Square, Borough of Manhattan, City and State of New York, on September 7, 1949, at 10:30 A. M., or as soon thereafter as counsel can be heard, for an order in the form hereto annexed, authorizing I. Howard Lehman, Lester T. Doyle and James Hodes as Trustees of Surface Transportation Corporation of New York to pay for 25 Johnson fareboxes purchased in August and to purchase 334 additional fareboxes, and as Trustees of Westchester Street Transportation Company, Inc. to purchase 115 fareboxes from the Johnson Farebox Company, upon the terms set forth in the annexed petition; and for such other and further relief as to the Court may seem just and proper.

New York, N. Y., September 2, 1949.

SAXE, BACON & O'SHEA,
Attorneys for Trustees,
102 Maiden Lane,
New York 5, N. Y.

To:

The attorneys for all parties who
have filed notices of appearance herein.

Sept. 7, 1949

Respectfully referred to Judge Kaufman.

EDWARD A. CONGER,
U. S. D. J.

Motion granted. Order signed Sept. 8, 1949.

SAMUEL H. KAUFMAN,
U. S. D. J.

Exhibit "D" Annexed to Stipulation as to Facts.

Order Authorizing Trustees to Pay for 25 Fareboxes Purchased and to Purchase 449 Additional Fareboxes From Johnson Farebox Company.

(2)

Upon the petition of I. Howard Lehman, Lester T. Doyle and James Hodes, Trustees of debtors Surface Transportation Corporation of New York and Westchester Street Transportation Company, Inc., verified September 1, 1949, and the notice of motion thereto annexed dated September 2, 1949, and said petition and notice of motion having been duly served, and after the hearing on said petition, and sufficient reason appearing therefor, it is hereby

ORDERED, that the Trustees of debtor Surface Transportation Corporation of New York be and they hereby are authorized to pay Johnson Farebox Company the sum of $6,213.00, being the purchase price of 25 fareboxes received by said Trustees in August, 1949; and it is further

ORDERED, that the Trustees of debtor Surface Transportation Corporation of New York be and they hereby are authorized to purchase an additional 334 fareboxes from the Johnson Farebox Company for the sum of $83,005.68; and it is further

ORDERED, that the Trustees of Westchester Street Transportation Company, Inc. be and they hereby are authorized to purchase 115 fareboxes from the Johnson Farebox Company for the sum of $28,055.40.

New York, N. Y., September 8, 1949.

SAMUEL H. KAUFMAN,
U. S. D. J.

Exhibit "D" Annexed to Stipulation as to Facts.

Petition by Trustees for Order Authorizing Payment for 25 Fareboxes Purchased and Purchase of 449 Additional Fareboxes From Johnson Farebox Company.

(3)

To Honorable Samuel H. Kaufman, Judge of the United States District Court for the Southern District of New York:

The petition of I. Howard Lehman, Lester T. Doyle and James Hodes, respectfully shows:

1. Your petitioners are the duly appointed, qualified and acting Trustees of the above named debtors.

2. By the orders of their appointment dated June 21, 1949, as resettled, your petitioners were authorized and directed to continue the business of the debtors in the operation of street transportation facilities and your petitioners have been continuing such operations.

3. Your petitioners operate 68 bus routes in Manhattan, The Bronx and Westchester County, with a total route mileage of approximately 331 miles, and 12 trolley routes in The Bronx and Westchester County with a total route mileage of 36 miles. In connection with these operations your petitioners use approximately 1,000 buses and 84 street cars.

4. Prior to the institution of a fare higher than 5¢, all buses operated by the debtors were equipped with a so-called "J" type of (4) farebox. These boxes were so constructed that a nickel inserted therein would register as one fare and a dime as two fares. When a 7¢ fare was instituted on the debtors' buses, a tray was provided upon which the passenger dropped two pennies and inserted the

nickel in the farebox. Accordingly, at the end of each day's run the bus operator was required to turn in to the debtors 7¢ for every fare registered on the box. However, due to unfamiliarity or thoughtlessness on the part of the passengers, a certain percentage of passengers would insert the total fare in the box, which then registered five fares, since a penny registered two fares as did a dime. Considerable confusion developed with respect to the number of fares for which each bus operator should account. As a result, Division Superintendents of the debtors were authorized to refund to the bus operators the amounts erroneously registered, provided the operator made a claim and signed an appropriate refund slip.

5. In order to offset the inevitable increase in the number of fares registered in the box by such insertion of pennies, a percentage of the bus operators adopted the practice of taking certain fares "over the box" instead of having the fares inserted in the box. In the course of the last several months, as a result of investigations by debtors' inspectors, a number of bus operators were suspended for this practice. The union representing the operators has protested to the Trustees that the basic cause of this trouble was the failure of the debtors to provide proper fare collection devices.

6. In addition to the foregoing, it was recognized by the debtors that the method of collecting the pennies in a tray imposes an additional burden on the bus operators and also slows down the entrance of passengers into the buses. Consequently, the debtors made a survey of the market for the most practical farebox equipment for the collection of fares involving more than one coin or tokens. Debtors found that the Johnson farebox was the most suitable box

and that it was used by the Board of Transportation of the City of New York and other privately owned bus lines in this City.

7. On February 8, 1949, as a result of such survey, debtor Surface Transportation Corporation of New York (hereinafter called "Surface") placed an order with the Johnson Farebox Company for 450 boxes. At that time the debtors were using 400 of this type of box which had been borowed from the City of New York for use on the debtors' lines where combination subway-bus tickets were being sold. The Johnson Farebox Company delivered 226 boxes to the debtors up to June 21, 1949. In August that company delivered an additional 25 boxes to the Trustees.

(5) 8. At the time of placing the order for said 450 boxes, Surface recognized that an additional order would have to be placed at a later date, inasmuch as a total of 850 boxes (including those belonging to the City of New York) would not provide an adequate margin of reserve for boxes out of order. The need for additional boxes has been further accentuated by the recent purchase of 25 new buses by Surface for use in the City of New York.

9. At the time of the institution of a 7¢ fare on the lines of debtor Westchester Street Transportation Company, Inc. (hereinafter called "Westchester Street"), it placed an order with the Johnson Farebox Company for 115 of such boxes.

10. As a result of a study of the requirements of the debtors in this respect, your petitioners and the operating officers of the debtors are of the opinion that it is necessary to obtain an additional 334 boxes at a cost of $83,005.68 for use by Surface, and 115 boxes at a cost of

$28,055.40 for use by Westchester Street. These estimated requirements include the number of undelivered boxes covered in the purchase orders hereinabove referred to. The price for each box, which is standard for all purchasers, is $228, plus 7% Federal tax; and, if boxes are delivered for use in the City of New York, 2% New York City Sales Tax.

11. Your petitioners have been advised by the Johnson Farebox Company that in the event they receive such an order from your Trustees, deliveries will be made commencing approximately six weeks after the order is placed, at the rate of approximately 50 boxes per week.

12. At the present time debtor Surface owes to the Johnson Farebox Company the sum of $43,481. representing the cost of the 226 boxes delivered to said debtor prior to June 21, 1949; and in addition your petitioners are obligated to pay said company the sum of $6,213. representing the cost of the 25 boxes delivered to your petitioners in August 1949 as set forth.

WHEREFORE, your petitioners pray that an order be entered herein authorizing them (a) as Trustees of Surface Transportation Corporation of New York to pay Johnson Farebox Company $6,213., being the purchase price of the 25 boxes received in August 1949; (b) as Trustees of Surface Transportation Corporation of New York to purchase 334 fareboxes from the Johnson Farebox Company for the sum of $83,005.68 inclusive of Federal and New York City taxes; and (c) as Trustees of Westchester Street Transportation Company, Inc., to pur- (6) chase 115 fareboxes from the Johnson Farebox Company for the sum of $28,-055.40 inclusive of Federal taxes; and granting such other

and further relief as to the Court may seem just and proper.

I. Howard Lehman
Lester T. Doyle
James Hodes
Petitioners-Trustees.

Saxe, Bacon & O'Shea,
Attorneys for Petitioners, by

William J.
A Member of the Firm,
102 Maiden Lane,
New York 5, N. Y.

Southern District of New York }
State of New York } ss.:
County of New York }

We, I. Howard Lehman, Lester T. Doyle and James Hodes, the petitioners named in the foregoing petition, do hereby severally make solemn oath that the statements contained therein are true to the best of our knowledge, information and belief.

I. Howard Lehman
Lester T. Doyle
James Hodes

Subscribed and sworn to before me }
September 1st, 1949. }

Max Regov,
Notary Public,
State of New York.
Qualified in Bronx County.
No. 03-3233500.
Certs. filed: Bx. Reg.; N. Y. Co. Clk. and Reg.; Kings. Co. Clk. and Reg.; Westchester Co.
Term expires March 30, 1951.

Testimony

(14) IN THE MATTER

of

THIRD AVENUE TRANSIT CORPORATION.

New York, October 22, 1956,
10:30 o'clock a. m.

Present: Mr. BURNS,
Mr. KISER,
Mr. BANDLER,
Mr. LORENZ.

* * * * *

Also at this time, your Honor, we have on the agenda the matter of the claim for priority as a six months claim of Johnson Fare Box Company. Mr. Lorenz is here this morning and I am told that he is ready to proceed.

(30) The Court: Mr. Lorenz.

Mr. Lorenz: May it please the Court, I have here a stipulation that was entered into a few days ago with the attorneys for the trustee as to most of the facts in the situation, and I ask that it be marked Exhibit 1.

Mr. Kiser: Your Honor, may the record show that the stipulation was entered into with the reservation to object to the materiality and the relevancy of a number of statements contained therein, and in the argument and in our memorandum we will point out to your Honor the grounds for such a reservation.

(Marked Johnson Exhibit 1.)

Mr. Lorenz: In that stipulation, your Honor, there is reference to a number of mortgages which are attached thereto as exhibits but I have agreed with counsel for the

trustee that since those mortgages and indentures are already in evidence in the proceeding that they may be deemed as annexed to the previous stipulation of facts although they are not actually attached.

The Court: Very well.

Mr. Lorenz: Your Honor, this proceeding concerns the purchase price of a number of fare boxes (31) which had been supplied by Johnson Fare Box Company to the debtors in possession. They had been supplied in 1949 within a period of six months prior to the appointment of the trustee. The amount involved, the amount which is left unpaid, is something over $43,000 for which the trustee, rather, for which the claimant claims a priority.

The Court: What is the unpaid balance?

Mr. Lorenz: $43,533.84 as the unpaid balance. By the way, Mr. Kiser, have you our claim, our proof of claim? I don't know whether it is before the Court or not.

(Mr. Kiser hands paper to Mr. Lorenz.)

Mr. Lorenz: Will your Honor excuse me a moment?

The Court: Yes.

(Short pause.)

Mr. Lorenz: The original of our claim is on file with the trustee and if I may be permitted to hand up this copy for the convenience of the Court, I would be glad to do so.

Mr. Kiser: No objection.

Mr. Lorenz: And I suggest that it be marked Exhibit 2.

(32) (Marked Johnson Exhibit 2.)

Mr. Lorenz: Prior to the time that the 7 cents fare was granted on November 28, 1948, the debtor had used a form of fare box which they also bought from Johnson Fare Box Company over a period of years. I think those fare boxes were known as the J fare boxes. The debtors

had been purchasing fare boxes from Johnson for many, many years, certainly since before 1940, and I think from 1936.

I want to state that the terms of payment—and I believe this is of paramount importance in the situation—the terms of payment from 1940 have been on the basis of thirty days, one per cent discount, if paid in cash. Obviously it was on a current basis, and it was clear, even with respect to the fare boxes here involved, and as stated in the stipulation, that the debtors had asked for extended terms of credit and that those terms of credit had been refused, so that there is no intention on the part of Johnson Fare Box Company to extend long term credits for these fare boxes.

The Court: They could take off one per cent if they paid within thirty days?

Mr. Lorenz: Yes. Prior to 1940, as I (33) have been informed by Mr. Kiser, they were permitted to take off two per cent if they paid before thirty days.

Mr. Kiser: Ten days.

Mr. Lorenz: Or if they paid within ten days.

Mr. Kiser: It was net thirty days.

Mr. Lorenz: Net thirty days?

Mr. Kiser: Yes.

Mr. Lorenz: Now up to September 22, 1948, as I have stated, the fare on the lines was 5 cents. On November 28, 1948, a 7-cent fare was instituted on the buses. When the increased fare was instituted, in addition to the fare boxes, a tray was supplied for the delivery and the payment of the pennies by the passengers. In other words, if the entire fare was deposited in the fare boxes it registered not one fare for which the conductor was required to account but five fares because each penny registered a fare, just as a dime would. So that the situation was entirely confusing in that if the proper fare was deposited in the fare box, five fares were registered and not one.

Colloquy.

The conductor was permitted to make an (34) application to the superintendents of the respective lines for reimbursement of the additional sums which were shown to have been owing by him to the lines as registered in the fare box, and that, of course, was a troublesome and onerous thing to do.

As a matter of fact—and I think this is of vital importance—many operators of the buses got into the habit instead of taking the money over the tray or on the tray, because many of the passengers due to unfamiliarity with the system, deposited the entire seven cents in the box which would register five fares, and they took the fare over the boxes. In other words, they themselves received the entire amount and apparently there was no way of checking up as to what amount they had received, and I think that there was a large amount of trouble on the part of the lines as a result of that.

As a matter of fact, the superintendents of the respective lines made an investigation of the situation and a number of operators were suspended because they took fares over the box. The union—

The Court: I might get a lot more out of (35) this if I knew what the basis of the objection was that this is not a proper six months claim.

Mr. Kiser: Your Honor, the basis of our objection that this is not a six months claim is that the claim is not a current expense in the ordinary operations within the meaning of the six months rule in any sense of the word. It is a claim for the unpaid purchase price of fixed capital items and therefore is not a six months claim under that rule.

The Court: Thank you. Go ahead, Mr. Lorenz.

Mr. Lorenz: Directing my attention to that statement for a moment, we claim that the facts and circumstances

show that for all practical intents and purposes these were necessary changes which were made for the ordinary operation of the line, and we have a number of cases which show that it doesn't make any difference whether or not, as the trustee says, that these were handled as capital items on their books or not. We certainly intended them to be a matter of merchandise to be paid for currently.

The Court: Your position would be that if they had a power house or a garage and there was (36) a hurricane and it blew it down and they had to put up something so that they could operate their buses, that that would be a current expense; is that right?

Mr. Lorenz: Well, I do not have to go even that far with respect to a car barn blowing down, although some cases have gone so far as to say that even though a bridge is necessary, a new bridge is necessary to continue the safe and reasonable operation of a railroad, that under those circumstances that could be deemed as coming under the six months rule.

The specific case that I have in mind in that regard is the case of Continental Trust Company vs. Bonsal, in which certiorari was denied in 293 U. S. 634. Unfortunately I do not have the Federal Circuit—yes, it is 72 Fed. (2d) 975.

And in some cases rails in very considerable quantities were purchased by a railroad and were deemed necessary. That is the famous case of Southern Railway Co. vs. Carnegie Steel Co., 175 U. S. 257.

I think that the case, our case, is a fortiori stronger than the situation which your Honor has mentioned; that it is clear that these things were used, (37) as the stipulation shows, in the ordinary operations of the company. They were not new fare boxes; they were replacement fare boxes. They were intended as replacements. They were used as replacements and solely as replacements. I want to emphasize that.

Colloquy.

In the Bonsal case the very question which Mr. Kiser has raised was discussed, and in many other cases they say that the mere fact that a Public Service Commission or even the ordinary accountant might consider these things as capital items which may be depreciated is not decisive of the question at all, and it has been so held by many courts.

And I believe that is our situation. In other words, this is just a situation similar to the subway when the fares were changed from five cents to ten cents and a man was required to stay there and accept dimes in a tray instead of nickels in the slot. Now that may be a more extreme situation than the one here but in essence it is essentially the same. And when we say that it was necessary for the continued operation of the lines, it was necessary from all practical points of view.

The union stated that the reason these errors were made and that these situations were created (38) by which the motorman took the fares over the box was due to the fact that there not proper fare boxes installed in the line. And I think that that also is in the stipulation of facts which I have presented to your Honor.

Now it is interesting to note that during this period 400 fare boxes of this kind which we furnished during the period in question were borrowed by the transit company from the city and used for the operation, the joint operation of the city and the bus lines.

Now I think that perhaps one of the most important aspects in the situation is that on September 2, 1949, just two months I think after the trustees were employed or were appointed, an application was made by the trustees of the lines to do several things, to pay for certain fare boxes which were delivered by Johnson in August 1949 apparently without any specific authorization from the court, and they requested that they pay for them because

they had been delivered. The situation there is precisely the same as these except that they were delivered after the appointment of the trustee, and in addition they asked for authority to buy 334 more of these boxes (39) in addition to those which had been delivered, obviously because they deemed it necessary for the operation of the lines, and in addition to that 150 still more fare boxes for the Westchester Line, making a total of almost 500 additional boxes which they ordered from Johnson after the trustees or immediately after the trustees were appointed.

Many cases have held that where a receiver or a trustee acts in that way immediately after his appointment it shows pretty definitively that these were necessary for the continued operation of the line.

I have here the application of the trustees for the permission to make those additional purchases.

It is annexed as an exhibit to the petition. I hand it up to your Honor, and the facts which I have stated to you are almost verbatim from this petition. It is referred to in the petition as an exhibit and I ask also that it be marked.

(Marked Johnson Exhibit 3.)

Mr. Lorenz: I also want to point out what I think is an important fact, and that is that prior to the appointment of the trustee this line or these lines were under the jurisdiction of the court. (40) There was also the Securities and Exchange Commission which was interested. There was also the City of New York which was interested. The Public Service Commission was also interested. They must have known that Johnson was furnishing fare boxes to enable the company to operate in a reasonable way. No objection was ever made to the

acquisition of these fare boxes while the companies were under the jurisdiction of the court. In fact, no receiver had ever been appointed by the court. And when a receiver—when an application for a receiver was made in June 1949 the court refused to appoint a receiver in the situation, and the statute says that no purchases shall be made by the company except in ordinary operations of the business.

By stipulation here it was agreed that these fare boxes were purchased before and used in the ordinary operation of the business. I think that really, wholly apart from the six months rule, that these were really purchases made by the debtors, who then happened to be in possession, for the preservation, the reasonable preservation of the system and the property, and also the fact that the purchases were made within the six months period.

(41) So that under the circumstances I think that since the mortgagee has received the benefits of these additional fare boxes, since nobody has been hurt by them, since they were furnished in entirely good faith to allow the company to operate under the 7 cents fare which they couldn't operate in the usual way since—as a matter of fact although it is not stated in the stipulation, not only did the union say that the reason for the difficulty was that there was not a proper fare box but that there would be a strike if additional fare boxes of the kind furnished by Johnson Fare Box were not purchased.

So it seems to me, your Honor, that a clear case is made out for the application of the priority principle under the six months rule. And I might say that I understand that the trustees have set aside more than enough money to cover this six months claim as well as others which your Honor has heretofore allowed.

This whole question came up, as a matter of fact, in an application many years ago before the court, before a

referee. It was heard before a referee, briefs were prepared for the referee and apparently it was never submitted on behalf of the trustee.

(42) So I ask your Honor to grant our application.

The Court: Did the Johnson Fare Box Company furnish any fare boxes before the beginning of the six months period which were not paid?

Mr. Lorenz: Oh, yes, they did.

The Court: And as to those you have a general claim for them?

Mr. Lorenz: Well, to that extent, we are not making any claim for that. For many years—

The Court: I didn't mean that. I mean did you furnish any for which you were unpaid?

Mr. Lorenz: I don't know, your Honor. I think that they were all paid. They have all been paid but I wouldn't make any claim for those because of the court's general disposition to not allow the priority principle to go beyond six months.

The Court: Still if you are right about your point it doesn't make any difference whether it is six months or not as long as—

Mr. Lorenz: I don't think they are in a substantial amount in any event and that is not something we are making a claim for before your Honor.

Perhaps Mr. Ellis can tell us whether there (43) have been any furnished prior to the six months period which are still unpaid. That is what the Court is referring to now.

Mr. Ellis: No, there are none for which payment has not been made.

Mr. Lorenz: Thank you.

Mr. Kiser: Your Honor, if I may address myself first to the relevancy of Mr. Lorenz's references to the proceeding before the referee, those proceedings have nothing

to do with the classification of Mr. Lorenz's claim. That was a supplementary proceeding and at the time $12,000 was paid to Johnson Fare Box Company during the pendency of the reorganization proceeding. Similarly, the fact that they were paid something on acount between the time the petition was filed and the trustee appointed is equally irrelevant to this proceeding. Substantially all of the proceedings before the referee were settled and the only two which weren't, the referee had not seen fit to decide them, and we hadn't pressed the referee for decision, and to my knowledge neither have the other parties to the proceeding. They refer solely to the validity of the payment made during the pendency of the involuntary (44) proceeding before the referee was appointed.

Now there are two questions here with which I think your Honor is principally concerned. Your Honor suggested a question to Mr. Lorenz whether he was contending that his situation was comparable to one where a roof had blown off the property and he mentioned a situation where a bridge had been washed away.

Now I would contend that there is nothing in the record before your Honor to support any claim of necessity in that situation. It is conceded that the bridge had not been blown away. It is conceded that the acquisition of these boxes tended to create a more efficient operation. It is equally clear, however, from the record that there was never any stoppage of operations even though, as Mr. Lorenz has just told you, all the boxes were not acquired during the period and delivered to the debtor. I believe the papers will show that only 226 out of the 450 were delivered, and they will also show that many more were acquired later on. So that while they certainly contributed to the efficiency of the operations there was no necessity in the sense—

Colloquy.

The Court: What is your point, that if they (45) were necessary every bus would have had to be equipped with them and if they were equipped gradually that it wasn't necessary?

Mr. Kiser: Yes. If they were necessary in the sense of a roof having been blown off in a hurricane or a bridge having been out on a railway, if it were necessary in that sense as distinguished from necessary to a most efficient operation. However, that is not the critical point here because the doctrine of necessity is a very limited one, and I think that the cases will show, your Honor, that it means actual necessity rather than desirability.

Passing then from the point of necessity to the more normal and usual application of the six months rule, the cases, and I will not say uniformly hold because there are cases within this field, I think, as your Honor will recall, supporting almost any proposition. That is to say on occasions some courts have been quite liberal in extending the doctrine, but, as most of the cases define the rule, six months claims are claims for current expenses. Our position is that it never was an expense claim and that it couldn't be an expense claim. I think (46) Mr. Lorenz stated it accurately when he stated the claim to be for the unpaid balance of the purchase price of fare boxes, and I would like to ask Mr. Ellis a few questions just to get on the record from an accounting point of view the nature of these transactions.

Mr. Ellis, will you take the stand.

James T. Ellis—For Trustee—Direct.

JAMES T. ELLIS, having been previously sworn, called as a witness on behalf of the trustee, testified as follows:

Direct Examination by Mr. Kiser:

Q. Mr. Ellis, are you employed by the trustee in reorganization? A. Yes, I am.

Q. In what capacity? A. As comptroller.

Q. And were you previously employed by the debtor corporation prior to the appointment of the trustee? A. I was.

Q. And in what capacity? A. First as accounting consultant and later on as vice president and treasurer of the company.

(47) Q. When did you first come with the company? A. October 1, 1948.

Q. You are a certified public accountant of the State of New York? A. Yes, I am.

Q. Are you familiar with the facts and circumstances surrounding this claim? A. Yes.

Q. Mr. Ellis, I ask you, is the claim of Johnson Fare Box Company a claim for current expenses of ordinary operations?

Mr. Lorenz: Your Honor, I object to the question.
The Court: Yes, the objection is sustained.

Q. Mr. Ellis, as an accountant, how would you characterize the claim of Johnson Fare Box Company? A. It is a claim for the payment of the purchase price of fixed assets except for the sum of $42.84.

Q. Now, Mr. Ellis, tell us how the sum of $42.84, how that much of the claim differs from the balance of the claim of $43,533.84? A. That is the cost of 15 housings for lights used in connection with the fare boxes. Under normal (48) circumstances those items would not be capitalized. They would be charged to materials and sup-

plies and drawn out and used to install—used out as part of the installation of the lights in the boxes.

Q. Would you describe in some detail the accounting transactions or bookkeeping transactions which took place with respect to the $42.84 item and with respect to the balance?

Mr. Lorenz: Your Honor, I do not believe that is relevant to the situation and certainly it is not determinative of the situation because the Court of Appeals has said that even though they may be depreciated, even though a public service body may demand that they be depreciated, even though they may be deemed as capital items on their books, it is not determinative of the situation. If the matters are to be paid within a short time without the extension of long term credit of any kind they are to be regarded as current liabilities.

The Court: You are not saying that that is an inflexible rule of law—

Mr. Lorenz: No, the courts have repeatedly so stated.

The Court: That it is of no moment whether (49) these are capital expenditures or current expenditures?

Mr. Lorenz: Did I say it is of no moment?

The Court: You cannot say that there is any such position and so it is admissible in evidence.

Q. What is your answer, Mr. Ellis? A. On the purchase of items such as were represented by the bills for $42.84, we would charge inventory of materials and supplies and credit accounts payable. On payment of the bill we would charge accounts payable and credit cash to record the disbursement of the cash and payment of the bill. On the purchase of the –

Q. If I may interrupt you, Mr. Ellis, on the payment of the sum of $42.84 there would be a charge to expense in

that sum, would there not? A. Not necessarily; it would be a charge against the accounts payable account to wipe that out. When the item was taken out of inventory materials and supplies and used on the boxes it would then be charged to expense. It is an item of the type such as is represented by the $42.84 charge. On the fare box purchases, such as the first item of $6,213, that would be charged to fixed capital property in (50) the service and an account payable would be set up at the time of the purchase. When the bill was paid the accounts payable would be charged and cash would be credited. The cost of the fare box itself would remain in the operating property and service account until such time as it was retired from service.

Q. You testified, Mr. Ellis, that an account would be set up I believe on the assets side which you say was fixed assets? A. Fixed assets operating property.

Q. Would that be depreciated over a period of years? A. Yes, it would.

Q. And what would the period of years be from 1948? A. Ten years. We are using a ten-year write-off period for all fare box equipment.

Mr. Kiser: Thank you, Mr. Ellis.

Cross Examination by Mr. Lorenz:

Q. There is no doubt in your mind, Mr. Ellis, is there, that this is a current liability of the company? A. There is no doubt that it was set up as a current liability at the time of the purchase, that is (51) right.

Q. Immediately at the time of the purchase it was a current liability? A. Yes, it was.

Q. And no long term credit was granted by the Johnson Fare Box Company, was it? A. That is correct.

Q. And these fare boxes were used, were they not, to replace existing fare boxes which had become not prac-

ticable because of the increase to the 7 cents fare, isn't that right? A. Yes, they were used to replace the J boxes which did not perform satisfactorily with a fare involving the collection of pennies.

Q. And they were not purchased for inventory purposes, were they? A. No, they were not except that some of them were reserved and some were not. They were kept in reserve to replace broken boxes and boxes that failed in service.

Q. But, as a matter of fact, you did not even have enough for the existing boxes that were in use, did you? A. We didn't in this purchase, no.

(52) Q. Did you in any other purchase? A. Well, we purchased some from the City of New York.

Q. You borrowed them from the City of New York, didn't you, four hundred of them? A. We borrowed them originally and then entered into a lease purchase arrangement.

Q. When was that? A. I think the lease purchase arrangement was in 1950 but it may have been late 1949.

Q. Did you read the application for permission to borrow these boxes in which it is stated explicitly that these were borrowed from the City of New York? A. They were borrowed originally and then we entered into a purchase lease arrangement at a later date, I believe after the appointment of the trustee.

Q. After the appointment of the trustee? A. Yes.

Mr. Lorenz: That is all, Mr. Ellis.

(Witness excused.)

Mr. Lorenz: I just want to read to your Honor a statement. I am not sure whether it is an exact quotation but it is close enough to be, in the (53) Bonsal case it says that the fact that it was charged to capital accounts under the I.C.C. rule does not prevent the expenditure from being a current expense, and it cited Virginia and Alabama Coal Company, 170 U. S. 355.

Colloquy.

The Court: I see that I have a question of law to decide.

Mr. Lorenz: I think it is primarily a question of law.

Mr. Kiser: Your Honor, I think we would both like some time to submit to your Honor all the precedents which we think will have some bearing on this matter and I was wondering if I could suggest that your Honor direct that we exchange our main briefs in ten days with five days additional for replies, if that meets with your Honor's convenience.

I believe you said that was satisfactory to you, Mr. Lorenz?

Mr. Lorenz: Yes.

The Court: All right, so ordered.

Mr. Kiser: Thank you very much.

Mr. Lorenz: I might say in response to your Honor's statement as to whether this is a question of law, it is a question of law in which the (54) discretion of the Chancellor is invoked to a considerable degree, because the courts have many times said you must consider all the facts in each specific situation. I don't think that there is any alchemy in the word "necessary" or in the question of reasonable necessity from the point of view of efficient operation in my opinion.

The Court: I have discovered that this is a very difficult field of the law because there doesn't seem to be any guiding principle and it is largely a matter of precedent so far as I am concerned. I don't know of any other way to decide the case as long as no principles are involved, and it would be either leaving the money in the pockets of the securityholders or taking it out of their pockets and putting it into the pockets of the Johnson Fare Box Company.

Mr. Lorenz: The securityholders have benefited by these additional fare boxes.

The Court: But that is true in every case except the case of an improvident purchase, Mr. Lorenz.

Colloquy.

Mr. Lorenz: Many cases have held that where the securities of the mortgages are preserved by this purchase that under those circumstances the priority is granted. We will have some of those cases for your (55) Honor.

I understand the shadowy line in the picture full well. We have struggled with the situation for a long time but I think you should certainly consider whether or not from an equitable point of view the interests of the security-holders have been safeguarded by the purchase. As to an improvident purchase the situation is different and we know that full well, but still where a securityholder is protected in his security by the purchase and I submit that they have benefited by the purchase, under those circumstances there is no sufficient reason why they should be protected as against the Johnson Fare Box Company who did supply these fare boxes at the urgent request of the trustee.

When they state that we did not furnish fare boxes during the period the principal reason was that we couldn't supply them quickly enough. The application says that they will have to order additional fare boxes to cover the boxes on hand, and everything must be considered in the light of the circumstances. If it was necessary that it be done it had to be done quickly, so that the union would be satisfied, and it was admitted that it would (56) load up the operation of the line and I imagine that it necessarily involved some concomitant danger in operation. It did not only involve additional obligations on the part of the motormen but it involved all sorts of hazards as to the efficiency of the line and I think its safety and the safety of the passengers. And under those circumstances it seems to me that the company was provident in ordering the fare boxes and I think that the trustees were provident in immediately—and when I say immediately I mean a month or two after the appointment, in not only ordering the ones which had been delivered but still an additional number,

and in addition to that they paid for 25, recognizing the urgency of the situation, and that urgency is something which the Court ought to recognize as an important factor in consideration of the question of law which is before it.

So when you say that it is a question of law, I agree that it is a question of law depending upon the facts which are presented underlying the law.

Mr. Kiser: I think that Mr. Lorenz went considerably outside the scope of the situation and I think he may have inadvertently said something which on futher reflection he will withdraw. Mr. (57) Lorenz, I believe you said that the Johnson Fare Box Company delivered these boxes just as fast as they could in response to Third Avenue's order.

Is it not a fact that on one occasion Johnson Fare Box stopped boxes in transit on the way to Third Avenue and generally slowed down all deliveries because of Third Avenue's slowness in payments?

Mr. Lorenz: I don't think that I have to retract anything that is true. At one time when there was a delay in payment of their obligations, their current obligations, we stopped the delivery in transit and immediately upon payment we delivered them. We delivered those which had been stopped and I think that the fact that in their desperate financial situation they paid the obligation when they saw that we were refusing to deliver them unless they paid, shows the current nature and the immediate nature of the obligation.

The Court: That is represented by the payment on account of about twelve thousand dollars?

Mr. Lorenz: Yes, that is right.

The Court: All right, we will consider the matter submitted except for briefs.

Mr. Kiser: Thank you.

Memorandum.

(252)

Bimock, D. J.:

Johnson Fare Box Company disputes the Trustee's failure to classify the liability to it as a "six-months claim". In the Trustee's proposed plan of reorganization "six months claims" are described, in Article I, as follows:

> "Six months claims: All claims, as defined, which are entitled to priority consisting mainly of claims for current expenses of ordinary operations incurred by the debtors without the extension of long term credit and within six months prior to the appointment of the Trustee in reorganization proceedings."

The parties have stipulated most of the facts. Johnson Fare Box has filed claims against the debtors Surface Transportation Corporation of New York (hereinafter Surface) and Third Avenue Transit Corporation in the amount of $43,533.84 for the unpaid balance on the purchase price of 225 new fare boxes delivered between February 7, 1949 and June 10, 1949. The Trustee now concedes that $42.84 of this amount is entitled to classification as a six months claim. The amount now remaining classification of which is in dispute is $43,491.00.

The fare upon the debtors' buses, was 5¢ until September 22, 1948. Prior to that date all buses operated (253) by them were equipped with a so-called "J" type of fare box. These boxes were so constructed that a nickel inserted therein would register as one fare and a dime as two fares. If a penny were dropped in it also would register as two fares. On September 22, 1948, the fare was raised to 6¢ and, on November 28, 1948, to 7¢.

Memorandum.

The expedient of collecting the extra pennies on a tray beside the fare box proved entirely inadequate. Passengers would drop the pennies into the fare box where each would register two fares as if it were a dime so that if 7¢ were dropped in five fares would be registered. This involved claims for refund by the bus operators and also attempts by the bus operators to square accounts by accepting fare "over the box" instead of in it. The substitution of boxes which would register the pennies therefore became imperative and on February 8, 1949, Surface placed an order with Johnson for 450 fare boxes at a cost of $228 per box.

The claim here put forward as qualifying for the six months class is for the purchase price of 225 of the fare boxes so ordered.

The contested classification of claims as non-priority claims was before the District Court on a prior application in this proceeding. In Re Third Avenue Transit Corporation, 138 F. Supp. 623, aff'd on opinion below, 230 F. 2d 425. In that opinion the District Court quoted at page 625 and used as a rule a statement by Franklin W. M. Cutcheon, Esq. as reported by Fitzgibbon in his "The Present Status of the Six Months Rule", 34 Col. Law Rev. 230, 234-235. I will use the same statement as the rule for the decision of this application. It follows:

> "Debts contracted by the railroad company within a reasonably short time prior to a receivership, whether under a foreclosure bill or a creditor's bill, that is to say, within a period, usually fixed at six months * * * for labor, supplies or material or repairs necessary (254) for the operation of the railroad as a going concern, if it does not appear that credit was given in reliance upon the railroad company's personal credit or some special security, are preferred over

the lien of a mortgage and the claims of bondholders as to net income, whether that of the railroad company or that of its receivers, even if necessary as to income impounded by the mortgage trustee. * * *

"Debts of the railroad company for money loaned, for new construction, for general reconstruction (as distinguished from repairs), for the purchase of land and right of way, for additions and betterments which are not chargeable to operation, for the purchase of new equipment, for so-called car rentals payable under equipment trust agreements, for rentals under leases, for guarantees of securities of other corporations and for tort claims do not fall within the class of preferred claims, even as to surplus income, unless some special equity attaches to the claim."

Applying the above quoted rule, the fare boxes were not "labor, supplies or material" but rather "new equipment".

The liability is classified to the extent of $42.84 as a six months claim. As to the balance, classification as a six months claim is denied.

E. J. Dimock,
United States District Judge.

Notice of Appeal.

(257)

UNITED STATES DISTRICT COURT,

SOUTHERN DISTRICT OF NEW YORK.

[SAME TITLE]

NOTICE is hereby given that Johnson Fare Box Company, claimant above named, hereby appeals to the United States Court of Appeals for the Second Circuit from the memorandum order of this Court entered on March 15, 1957, denying the classification of its claim against Surface Transportation Corporation of New York and Third Avenue Transit Corporation herein in the sum of $43,533.84 (except as to the sum of $42.84), as a six months' priority claim.

Dated: New York, May 10, 1957.

LORENZ, FINN & GIARDINO,
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To:

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Corporation of New York and Third
Avenue Transit Corporation,
20 Exchange Place,
New York City.

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JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

JOHNSON FARE BOX COMPANY,
Petitioner,

against

LESTER T. DOYLE, Trustee in Reorganization of THIRD AVENUE TRANSIT CORPORATION, Debtor,

SURFACE TRANSPORTATION CORPORATION OF NEW YORK, Debtor,

WESTCHESTER STREET TRANSPORTATION COMPANY, INC., Debtor,

THE WESTCHESTER ELECTRIC RAILROAD COMPANY, Debtor,

THE YONKERS RAILROAD COMPANY, Debtor, and

WARONTAS PRESS, INC., Debtor,
Respondents.

PETITION FOR CERTIORARI

No. 1045

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

JOSEPH LORENZ,
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IN THE

Supreme Court of the United States

OCTOBER TERM 1957

JOHNSON FARE BOX COMPANY, Petitioner, *against* LESTER T. DOYLE, Trustee in Reorganization of THIRD AVENUE TRANSIT CORPORATION, Debtor, SURFACE TRANSPORTATION CORPORATION OF NEW YORK, Debtor, WESTCHESTER STREET TRANSPORTATION COMPANY, INC., Debtor, THE WESTCHESTER ELECTRIC RAILROAD COMPANY, Debtor, THE YONKERS RAILROAD COMPANY, Debtor, and WARONTAS PRESS, INC., Debtor, Respondents.	PETITION FOR CERTIORARI No.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

TO THE HONORABLE: THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Petitioner prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in the above-entitled case on January 6, 1958.

Citations to Opinions Below

The opinion of the District Court (46a-48a)* is not reported. The opinion of the United States Court of Appeals, printed in Appendix A, *infra*, page 24, is reported at 250 Fed. (2d) 656.

Jurisdiction

The judgment of the United States Court of Appeals was dated and entered on January 6, 1958 (54a) and is printed in Appendix B, page 28, *infra*. On April 2, 1958, Mr. Justice Harlan entered his order extending to June 5, 1958 the time of the petitioner to petition for a Writ of Certiorari (Appendix C, p. 29, *infra*).

The jurisdiction of this Court is invoked under 28 U.S.C. §1254 (1).

Questions Presented

1. Whether in a reorganization proceeding a claim for the price of fare boxes delivered to a railroad or transportation corporation within six months of the appointment of Trustees is entitled to priority where *admittedly*

(a) the claim was a current liability contracted with the expectation of the supplier that it was to be paid out of current earnings;

(b) the boxes were intended for and were used in the ordinary operations of the company, were used in old buses to replace boxes which had become obsolete with an increase in the fare, and did not involve an extension of the transportation system;

* Figures in parentheses refer to pages of the printed Appendix to Appellant's Brief in the United States Court of Appeals.

(c) the new boxes became subject to the existing mortgage and enured to the benefit of the mortgage holders;

(d) the substitution of new boxes for the old ones was found by the District Court to be "*imperative*"; and

(e) Shortly after the appointment of the Trustees, they ordered a large number of additional identical fare boxes of the character here involved, setting forth the urgent need therefor.

2. Whether a claim for the price of fare boxes (which would otherwise be entitled to priority under the six months' rule) should be denied priority on the sole alleged ground that the fare boxes were "new equipment" as distinguished from "labor, supplies or material".

Statute Involved

This proceeding does not involve the interpretation of any statute, although the question arises in the administration of the Federal Bankruptcy Act relating to reorganization proceedings.

Statement

This is a proceeding by Johnson Fare Box Company to have a claim in a reorganization proceeding given priority under the so-called "six months' priority rule." *Most of the facts have been stipulated.* The claim is based upon the delivery of fare boxes by Johnson Fare Box Company (hereinafter sometimes referred to as "Johnson") to Surface Transportation Corporation of New York (hereinafter sometimes referred to as "Surface") made between February 7, 1949 and June 10, 1949, which was within six months of the appointment of the Trustees on June 21,

1949 (10a). The aggregate amount of fare boxes delivered during said period amounted to $55,959.84, of which there was paid $12,426, leaving a balance unpaid of $43,533.84. Under an amended proof of claim (2a-4a), Johnson demanded priority for this claim over all first mortgage bondholders, adjustment income mortgage bondholders, and all general creditors, except general creditors in the same class as Johnson. Priority was granted by the District Court to the extent of $42.84, leaving a balance in the amount of $43,491, which is the subject of this proceeding.

The jurisdiction of the District Court was invoked because the question related to a reorganization under the Federal Bankruptcy Act.

In the year 1949, the Debtors operated a public transportation system with buses and street cars in the Boroughs of Manhattan and the Bronx (New York City) and in the County of Westchester (New York State). Its operation required about 981 buses and 84 streets cars to carry passengers over 68 bus lines with a total route mileage of 331 miles, and 12 trolley routes with a route mileage of 36 miles (8a).

During the years 1948 and 1949, the total number of revenue passengers carried were 420,000,000 and 355,021,901, respectively (8a).

Until on or about September 22, 1948, the fare was five cents and all buses were equipped with a so-called "J" type of fare box, which was so constructed that a nickel inserted therein would register as one fare and a dime as two fares (11a).

On November 28, 1948, a seven cents fare was instituted. Thereafter, a tray was provided in each bus upon which the passenger was supposed to drop two pennies and insert a nickel in the fare box (11a). Due to unfamiliarity or thoughtlessness on the part of passengers, a certain percentage of them would insert the total fare in the fare

box, which then registered five fares, since a penny registered two fares, like a dime (11a). Considerable confusion developed with respect to the number of fares for which each bus operator should account (24a). As a result, Division Superintendents were authorized to refund to the bus operators the amounts erroneously registered, provided the bus operator made a claim and signed an appropriate refund slip (11a).

In order to offset the inevitable increase in the number of fares registered in the box by such insertion of pennies, many bus operators adopted the practice of taking certain fares "over the box" instead of having the fare inserted in the box (11a-12a). This practice opened the door wide to dishonesty and peculation on the part of the bus operators. In the course of several months, as a result of investigations by inspectors of Surface, a number of bus operators were suspended for this practice (12a).

The bus operators' union objected to the suspension and protested to the management that the basic cause of the trouble was its failure to provide proper fare collection devices (12a).

The Debtors recognized that the method of collecting the pennies in a tray imposed an additional burden on the bus operators and also slowed down the entrance of passengers into the buses (12a). As a result, they made a survey of the market to find the most practical fare box for collecting fares involving more than one coin. They found that the Johnson fare box (of the type here involved) was the most suitable and that it was used by the Board of Transportation of the City of New York and other privately owned bus lines in New York City. In fact, the Debtors, because of their urgent necessity, were then using 400 of them which they had borrowed from the City of New York (12a, 24a-25a).

Accordingly, on February 8, 1949, as a result of said survey, Surface placed an order with Johnson for 450 boxes

at a cost of $228 per box, plus 7% Federal Tax and 2% New York City sales tax, if the boxes were delivered for use in New York City. The Debtors requested credit for these purchases, but this was refused. Instead, Johnson insisted upon and Surface agreed to terms of thirty days net, and 1% discount if payment was made within ten days (10a). The Debtor's liability for payment for said boxes was a current liability, and the claim of Johnson represents a debt contracted with the expectation or intention of Johnson that it was to be paid out of the current earnings of the Debtor. The fare boxes so ordered and delivered were intended for and were actually used in the ordinary operations of Surface (13a). All of the fare boxes so ordered and delivered were intended for use and were actually used on old buses then in use, as replacements for the previously used "J" boxes. They were purchased for immediate use and not to provide an adequate margin of reserve for boxes out of order (13a).

Johnson had delivered 226 boxes up to June 21, 1949, the date of the appointment of the Trustees (25a).

It is undisputed that the fare boxes so delivered became part of the security included in the First Refunding Mortgage (16a).

On or about September 2, 1949, shortly after the appointment of the Trustees herein, the Trustees petitioned the District Court for leave to purchase 334 additional fare boxes for Surface and 115 additional fare boxes for the Debtor Westchester Street Transportation Company, Inc. The petition alleged that these additional boxes were being purchased "as a result of a study of the requirements of the debtors in this respect," and that the trustees and

> "the operating officers of the debtors are of the opinion that it is *necessary* to obtain an additional 334 boxes at a cost of $83,005.68 for use by Surface, and 115 boxes at a cost of $28,055.40 for use by Westchester Street." (25a-26a) (Emphasis supplied)

The petition referred to the earlier order of Surface for 450 boxes, placed with Johnson on February 8, 1949, and alleged that Johnson had delivered 226 of the boxes up to June 21, 1949, the date of the appointment of the Trustees. The petition then stated that the Trustees themselves had accepted delivery of an additional 25 boxes in the month of August 1948 (25a), that is, prior to the filing of their petition and, therefore, without prior approval of the Court.

The petition further alleged that the additional boxes to be purchased included the boxes previously ordered by Surface on February 8, 1949, but not as yet delivered (26a).

That petition was granted on September 8, 1949, and the order entered thereon authorized the Trustees to purchase a total of 449 additional fare boxes at a cost of $111,061.08, and *to pay for the 25 boxes which they had accepted without prior Court approval in August 1949 (22a).*

Johnson's Amended Proof of Claim (2a-4a) requested priority upon the grounds, among others, that the fare boxes were delivered to a transportation corporation within a period of six months prior to the appointment of the Trustees and were necessary for the continued operation of Surface; that the purchases were made in the ordinary course of business of Surface, were made to preserve the estate and were in the nature of "administration expenses"; and that the fare boxes became subject to the mortgage, thereby enriching the estate of the mortgagee and the Debtors without consideration.

At the District Court hearing on this claim, Mr. James T. Ellis, Comptroller for the Trustees and formerly Vice President and Treasurer of the Debtors, testified that, of the items included in the claim of Johnson, the sum of $42.84 representing fifteen housings for lights used in connection with fare boxes, had been charged to materials and supplies. The balance, however, representing fare

boxes, had been charged to "fixed capital property" which would be depreciated over a period of ten years (41a).

The District Court, after reviewing the difficulties which resulted from the use of the old fare boxes when the new seven cents fare went into effect, found that:

> "The substitution of boxes which would register the pennies therefore became *imperative* * * *." (Emphasis supplied) (47a)

Nevertheless, the Court held that, in proceedings of this type, priority should be accorded only to claims for "labor, supplies or material", but not to "new equipment." The Court further found that the fareboxes were "new equipment", and accordingly denied Johnson's request for priority (48a).

The United States Court of Appeals held that the conclusion of the District Court was a proper interpretation and application of the rule, and affirmed (Appendix A, at p. 27, *infra*).

Reasons Why the Writ Should Be Granted

A. Conflict between United States Supreme Court and the Second Circuit.

The essence of the decision of the Court below is that the six months' priority rule is limited to "labor, supplies or materials"; *that it does not include "new equipment"*; and that fare boxes fall into the latter category. This decision is directly contrary to the decisions of this Court.

In the leading case of *Fosdick* v. *Schall*, 99 U. S. 235, this Court expressly included "equipment" within the scope of the six months' priority rule, when it stated at page 252:

> "The income out of which the mortgagee is to be paid is the net income obtained by deducting from

> the gross earnings what is required for necessary operating and managing expenses, *proper equipment* and useful improvements. Every railroad mortgagee in accepting his security impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income." (Emphasis supplied.)

At pages 251-2, this Court further stated:

> "• • • the court, in the exercise of a sound judicial discretion, may, as a condition of issuing the necessary order, impose such terms in reference to the payment from the income during the receivership of outstanding debts for labor, supplies, *equipment* or permanent improvement of the mortgaged property as may, under the circumstances of the particular case, appear to be reasonable." (Emphasis supplied.)

In *Southern Railway Co.* v. *Carnegie Steel Co.*, 176 U. S. 257, the question before the Court was the right of a creditor to priority for steel rails supplied to a railroad shortly before the appointment of receivers. The record showed that the rails were purchased in order that the road might be kept in a reasonably safe condition. This Court granted priority to the claim and stated at page 278:

> "As was said in *Fosdick* v. *Schall* • • • 'the income [of a railroad company] out of which the mortgagee is to be paid is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, *proper equipment*, and useful improvements'." (Emphasis supplied.)

Further, at page 285, the Court set forth the principles applicable to this type of case, as follows:

> "This court has uniformly refrained from laying down any rule as absolutely controlling in every case involving the right of unsecured creditors of a corporation, whose property is in the hands of a receiver, to have their demands paid out of net earnings in preference to mortgage creditors. But it may be safely affirmed, upon the authority of former decisions, that a railroad mortgagee when accepting his security impliedly agrees that the current debts of a railroad company contracted in the ordinary course of its business shall be paid out of current receipts before he has any claim upon such income; that, within this rule, a debt not contracted upon the personal credit of the company, *but to keep the railroad itself in condition to be used with reasonable safety for the transportation of persons and property, and with the expectation of the parties that it was to be met out of the current receipts of the company, may be treated as a current debt;* that whether the debt was contracted upon the personal credit of the company, without any reference to its receipts, is to be determined in each case by the amount of the debt, the time and terms of payment, and all other circumstances attending the transaction; and that when current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of any funds thus improperly diverted from their primary use." (Emphasis supplied.)

The case at bar comes squarely within the principles so laid down by this Court.

The Stipulation of Facts expressly states that Johnson's claim was a "current liability" of the Debtor and

that "said claim represented a debt contracted with the expectation or intention of Johnson that it was to be paid out of current earnings" (13a). The current nature of the debt is conclusively demonstrated by the fact that long-term credit was requested by Surface and refused by Johnson (13a), and that the terms of payment agreed upon called for payment within thirty days, with a 1% discount if payment were made within ten days (10a). It was further expressly stipulated that the fare boxes were intended for and were used "in the ordinary operations of the Debtor and Surface"; that the boxes were intended for and were actually used on old buses as replacements for the previously used "J" boxes (13a); and that they were purchased for immediate use and not as a reserve (13a). These stipulated facts clearly demonstrate that the transaction was made in the ordinary course of the Debtor's business.

It is unnecessary to argue that "equipment" of certain types is beyond the six-months' rule. If, for example, that equipment consisted of an extension of a railway system, or the new construction of a car barn, or the laying down of additional tracks or new cars or locomotives, we would agree that the six-months' rule did not apply. But in the present case, the fare boxes were physically but an insignificant part of a bus, and their cost in relation to that of a bus, was inconsequential. Their importance, however, in safeguarding the financial integrity of the transportation line, and in insuring the safety and efficiency of operation, was of the highest magnitude. Whether they are characterized as "equipment," rather than "material or supplies" is of no consequence. As we have shown above, the Supreme Court of the United States on a number of occasions has recognized that in a *proper* situation, "equipment or permanent improvements" or "proper equipment and useful improvements" come within the scope of the six-months' rule. The Supreme Court did not mean to imply that equipment such as extensions of a railroad system or new rolling stock was to be encompassed within the

rule. The word or phrase is not in itself the sovereign talisman. It is the purpose, meaning and intent behind the word by which we must be governed.

The boxes were not ordered for nor were they used in any new buses or new operating equipment. There was absolutely no extension of the Debtor's transportation system.

The purchase of the the boxes was, in the words of the District Court itself, "*imperative*" (47a). This urgent need arose as a result of the increase in the fare from five cents to seven cents, an increase which was obviously of fundamental importance to the Debtor. As heretofore stated, the old boxes were inadequate, because they were incapable of accurately recording the pennies involved in the new fare. The plan of having passengers drop a nickel in the old box and place the pennies in a separate tray proved unworkable. Despite the presence of the tray, many passengers dropped the full fare of seven cents—a nickel and two pennies—into the fare box. In view of the fact that a penny registered the same as a dime, the dropping of the seven cents into the old box resulted in the registration of five fares (or thirty-five cents), for which the operator was required to account, instead of seven cents. The operator was, therefore, required to pay over this entire sum, and then make an application for a refund. This immediately raised the question of the honesty of his application for a refund, since the operator could state any number of persons that he chose as the number who had deposited the entire seven cents in the box. *There was no possible check upon the accuracy or truthfulness of his application.* The money deposited in the fare box, as is common knowledge, is not allowed to remain in the box, but is removed from the box by the operator for the purpose, among other things, of supplying him with necessary change. The registration on the box would have no bearing upon the actual number of

fares for which the operators were required to account. Apart from the absence of any control over the fares, a considerable amount of time would necessarily be lost by the operators having the necessary adjustments made at the conclusion of their run or thereafter. They would inevitably request payment for the time so lost.

Moreover, it was stipulated that the method of collecting pennies in a tray imposed an additional burden on the operators. It is common knowledge that, in New York City, bus operators, operating all alone as they do, an entire bus, are already heavily overburdened. This imposition of "an additional burden on the bus operators" would inevitably give rise to dissatisfaction on their part, to claims for higher compensation, to more inefficient or distracted service, and to consequent jeopardy of the safety of the traveling public. It was further stipulated that the situation "also slowed down the entrance of passengers into the buses" (12a). The net result was that efficiency of operation was impaired with consequent reduction of use by the public and reduction of income, wholly apart from the impairment to the public of proper transportation service. It is obvious that the *safety of the traveling public* was likewise jeopardized, with the distractions, irritations and delays inherent in the situation, particularly where, as in New York City, a bus operator is already much overburdened with duties, being the sole operator of a bus, in complex and crowded traffic.

The insoluble difficulties created by this system are evidenced by the fact that, rather than attempt to work thereunder, or solve them, many operators adopted the practice of accepting fares "*over the box*" (12a). This means that the entire fare would be paid to the operator, and there would be no registration whatever of the fact that a fare had been paid. This placed the company completely at the mercy of the operators and presented an intolerable problem. Obviously, Surface could not permit such a practice and operators were suspended

therefor. This resulted in difficulties with the Union, because, as the Union properly contended, Surface did not have proper fare boxes on the buses (12a). The situation was so intolerable that the conclusion must be drawn that the purchase of new fare boxes, which would properly register nickels, dimes and pennies, was, as the Court below held, "*imperative*" to the proper operation of the bus system.

The pressing need of Surface for the new boxes is further evidenced by the fact that, at the time the order was given to Johnson, Surface was using 400 of this type of box which had been borrowed from the City of New York (12a).

Moreover, the action of the Trustees shortly after their appointment is highly significant. First, in August 1949, without prior permission of the Court, they accepted delivery of 25 of the boxes formerly ordered by Surface (25a). Then, on September 7, 1949, a petition was presented to the District Court which not only requested permission to pay for these 25 boxes, but also requested authority to purchase 449 additional boxes at a cost of $111,060.98 (26a). The petition traced the difficulties arising out of the use of the old boxes and clearly spelled out the need of the Debtors for the new ones. Included in the new order to be placed by the Trustees were the very boxes previously ordered by Surface, but not yet delivered. This additional order was being placed "as a result of a study of the requirements of the debtors", and the petition expressly stated that both the Trustees and the operating officers of the Debtors believed that it was "*necessary*" to obtain the additional boxes (25a).

The significance of the action of trustees, shortly after their appointment, on the question of allowing priority to debts contracted by a transportation company prior to their appointment was recognized by this Court in *Southern Railway Co.* v. *Carnegie Steel Co., supra.* In

that case, immediately after the receivers had taken possession of the railroad, they reported to the Court that the financial difficulties of the road during the previous two years had

> "prevented the operating officers from being able to expend the proper amount for new rails, and upon the roadbed and structures, to keep the railroad in the condition in which it should be maintained, and it will be necessary for the receivers, during the summer and autumn, to make a much larger expenditure than they would for ordinary maintenance." (p. 288)

Commenting on this report, the Court stated at page 288:

> "Here is a direct admission by the receivers that during the two years immediately preceding their appointment the railroad company had not expended for new rails and upon the roadbed and structures the amount necessary to keep its road in proper condition."

The Court then noted that, during the course of the receivership, additional rails were purchased by the receivers. After holding that such purchases were made in the ordinary course of business and payable out of current receipts in preference to the claims of mortgage creditors, and incurred in the interest of the mortgage creditors, the value of whose security depended upon the preservation of the railroad, the Court then stated at pages 289-290:

> "Why should a different rule be applied to the contracts made with the Carnegie Company shortly before the appointment of receivers * * *? Is it to be said that the contract for 2,000 tons of steel rails and the contract for 2,500 tons, made by the receivers

in the foreclosure suit, created debts of a preferential character, while contracts made by the railroad company of exactly the same kind shortly before the appointment of receivers for 2,500 and 1,656 tons of steel rails could not under any circumstances become a preferential debt chargeable upon current receipts? Surely the quantity of rails purchased from the Carnegie Company and delivered in 1891 was insignificant in view of the interests involved and the extensive mileage of the Danville system, and was by no means so large as to suggest that they were to be used in constructing new and additional road, and not to keep existing roads in proper condition for use. Every railroad company must have on hand a limited quantity of rails in order to keep every part of its line in proper and safe condition. It is evident that the Carnegie rails purchased shortly before the receivers in the Clyde suit were appointed—the rails here in question—were obtained for the same reason that induced the subsequent purchases by the receivers. No one will say that the use of these rails did not add directly to the value of the securities of mortgage creditors. Within the reason of the rule adverted to, the debts contracted with the Carnegie Company were as much current debts in the ordinary course of the business of the railroad company as were the debts contracted by the receivers under the orders of court, when they purchased new rails to put the road in safe condition, or when they purchased at one time four passenger locomotives, and at another time eight passenger and freight locomotives, the cost of which was charged upon the income in their hands. Is it to be said that such expenses incurred by the receivers were preferential debts, but that debts incurred by the railroad company shortly prior to the receivership for rails needed to keep its road in safe condition for use are not of that class?"

Similarly, in the case at bar, the fact that the Trustees, after their appointment, accepted delivery of 25 boxes previously ordered by Surface, requested authority to pay therefor, and further requested authority to order additional machines as "*necessary*" is the strongest proof that the purchases made by Surface within six months prior to the appointment of the Trustees were equally necessary for the ordinary operation of the business.

There is no doubt that the new fare boxes purchased by Surface were covered by the First Refunding Mortgage (16a) and enured, therefore, immediately to the advantages of the mortgage security holders.

The fare boxes were physically but an insignificant part of the bus, and their cost in relation to that of the bus was inconsequential. Their importance, however, in safeguarding the financial integrity of the transportation line, and in insuring the safety and efficiency of operation, was of the highest magnitude. Whether they be characterized as "equipment" or "materials or supplies" is of no consequence. The fact is that they were truly necessary to continue the Debtor as a "going concern". To be sure, the Debtor could have operated its buses with the old fare boxes or even without fare boxes, but no transportation company could conduct such an operation without early disaster. The fact that the buses without any fare boxes at all had the requisite motive power does not mean that boxes were not "necessary" in every practical sense of the word for their operation. A bus line of the scope and magnitude of the Debtor had to have proper fare boxes, and boxes which had been designed for merely a five cent fare were useless after the seven cent fare went into effect.

Under the decisions of this Court, therefore, the claim of Johnson is clearly entitled to priority.

B. Conflict Between the Second and Fourth Circuits.

The narrow interpretation of the six months' priority rule by the Courts below is clearly contrary to the decisions not only of the Supreme Court of the United States, but also of the United States Court of Appeals for the Fourth Circuit. In that Circuit, priority has been granted to claims arising out of such necessary improvements as the conversion of a power plant from steam to water, the repair of a bridge, and even the erection of a new bridge. Moreover, the cases have expressly held that the mere fact that the cost of the improvement was charged to capital by the utility, as was done in the case at bar, does not disqualify the claim from priority.

In *Virginia Passenger & Power Co.* v. *Lane Bros. Co.*, 174 Fed. 513 (CA 4th), the claimant was under contract to widen and deepen a canal in connection with the conversion of a power plant from steam to water. The Court in granting priority to the claim stated at page 517:

> "It may have been proper for the company, as a matter of bookkeeping, to charge this improvement to construction account, but it is plain that the indebtedness incurred was for the permanent improvement of the mortgaged property. It was not a new construction in the sense that the building of a new railroad, or the building of a new plant, would be, but was, as said by the Judge below, '*something necessary in furtherance of the more effective and economical operation of the existing plant*'." (Emphasis supplied)

The above language is precisely applicable to the fare boxes involved here. They improved the mortgaged property, enured directly to the benefit of the mortgagees, they did not go into *new* buses but replaced the obsolete boxes in the existing vehicles, they did not involve in any way an extension of the transportation system, and they were

certainly "something necessary in furtherance of the more effective and economical operation of the existing plant."

The Court in the *Virginia Passenger & Power Co.* case then referred to the fact that the receivers, after their appointment, petitioned for authority to continue and complete the project and that this authority was granted, and stated at page 517:

> "That the receivers and the general manager of the company considered that the completion of the work upon the canal was absolutely essential to keeping the company a 'going concern' is evidenced by their acts, and that the court which had the responsibility of protecting the property and its bondholders was impressed by its necessity is shown by its orders, among the first entered after the appointment of the receivers. If that be so, how can it be justly claimed that the work done by the petitioners during the month immediately preceding the appointment of the receivers was not of equal necessity?"

The direct applicability of such language to the case at bar has already been discussed.

A petition to review the *Virginia Passenger & Power Co.* case by a writ of certiorari was denied in 215 U. S. 610.

In *Continental Trust Co.* v. *W. R. Bonsal & Co.*, 72 F. (2d) 975 (C. A. 4th), priority was requested in connection with claims for cross-ties, stone, steel pier casings and structural steel which had been furnished for the repair of one bridge, which required strengthening, and *the erection of a new bridge*, which was required because of the age and weakened condition of another old bridge. In granting priority, the Court stated at page 980:

> "The objection to the allowance of priority chiefly stressed by appellants is that the supplies furnished

were not for operation but for improvements or betterments to the property of the road, which was charged to capital account under the rules of the Interstate Commerce Commission. But we do not think that this is a valid objection to the allowance of priority. As said in the Carnegie Steel Co. case, supra, 'a debt not contracted upon the personal credit of the company, but to keep the railroad itself in condition to be used with reasonable safety for the transportation of persons and property, and with the expectation of the parties that it was to be met out of the current receipts of the company, may be treated as a current debt.' And the rule as stated in Fosdick v. Schall, supra, repeatedly quoted with approval, lists debts *for improvements* along with those for labor, supplies, and *equipment* as being entitled to priority, if incurred in order that the railroad may be continued in operation as a going concern." (Emphasis supplied.)

The Court further stated at pages 980-981:

"The principles applicable in determining priority for such claims are entirely different from those which control in matters of bookkeeping. Charges to capital account in the books of the railroads are made for the purpose of determining the amount of investment as a basis of rate making, bond issues, etc. Priority is allowed claims for supplies under the 'six months' rule, not because the supplies have not added to capital, but because they have been necessary to the continued operation of the road and have been supplied with the expectation that they would be paid for out of current income.

* * * * * * * *

"They are debts of the income, not because they would ordinarily be charged to current expense, but because they have been necessary to the production of the in-

come in the ordinary operation of the road. * * * What we do mean to say, however, is that, where the debt meets these requirements (as discussed in the opinion), it is not to be denied priority merely because the supplies furnished have resulted in improvements to the property *or have been charged to capital account.* * * * And in the face of these holdings (cases cited), it would be little short of absurd to say that one who has furnished supplies necessary to keep the road in operation, and who is otherwise entitled to priority under the six months' rule, is to be denied such priority upon the objection of bondholders merely because the supplies which he has furnished have improved the property and thus increased the security of these bondholders. * * * But in considering what items are to be included in such operating expenses, due regard must be had for surrounding circumstances; and a claim for supplies necessary to the continued operation of the road is not to be denied priority *merely because such supplies have been used in a structure which constitutes an improvement over one which it replaces.* It is quite customary in the history of large and growing railroads to replace worn-out equipment with equipment of a more costly character, designed to meet the demands of modern traffic; and mortgage bondholders are, of course, aware of these recurring necessities and practices. In every such case, the exercise of reasonable judgment is required to decide whether, in view of the magnitude of the business and of the replacement of old by new and better equipment, the operation crosses the line of usual and customary practice and becomes a work of extraordinary character for which no priority may be allowed." (Emphasis supplied)

Again, in the *Continental Trust Co.* case, the Court took note of the fact that the receivers had completed the work on the bridge which had been started by the railroad com-

pany prior to the receivership, and this was an important factor in reaching the conclusion that a priority right existed.

An application to review this decision by writ of certiorari was likewise denied in 293 U. S. 624.

C. The question presented is of far reaching importance to railroads and other public service companies and in the administration of the Bankruptcy Act.

We are dealing here with problems which relate not to private litigants, but to railroads and transportation companies which intimately and vitally affect the general public. It is common knowledge that such companies operate largely on credit, as this Court pointed out as far back as *Fosdick* v. *Schall, supra,* at page 252:

> "The business of all railroad companies is done to a greater or less extent on credit. This credit is longer or shorter, as the necessities of the case require; and when companies become pecuniarily embarrassed, it frequently happens that debts for labor, supplies, *equipment* and improvements are permitted to accumulate, in order that bonded interest may be paid and a disastrous foreclosure postponed, if not altogether avoided. In this way the daily and monthly earnings, which ordinarily should go to pay the daily and monthly expenses, are kept from those to whom in equity they belong, and used to pay the mortgage debt. The income out of which the mortgagee is to be paid is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, proper *equipment* and *useful improvements.*" (Emphasis supplied)

It is apparent, therefore, that unless persons who would normally supply the materials and equipment necessary

for the continued operation of such companies are protected, they will withhold their vital credit and insist upon cash. Such a situation would obviously hasten the downfall of many companies whose finances are weak. The public interest requires that railroads and similar service companies be preserved and continued in operation in order to serve the general public. It is essential, therefore, that priority be accorded to creditors who, like Johnson, supply material and equipment necessary to keep them in operation within the recognized equitable period of six months prior to the appointment of a receiver or of trustees.

Conclusion

WHEREFORE, petitioner respectfully requests this Court to issue its writ of certiorari to the United States Court of Appeals for the Second Circuit.

JOSEPH LORENZ,
Counsel for Petitioner.

June 2, 1958.

Appendix A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 100—October Term, 1957.

(Argued December 5, 1957 Decided January 6, 1958.)

Docket No. 24731

JOHNSON FARE BOX COMPANY,

Claimant-Appellant,

—v.—

LESTER T. DOYLE, Trustee in Reorganization of THIRD AVENUE TRANSIT CORPORATION, Debtor,

Respondent-Appellee.

In the Matters of

THIRD AVENUE TRANSIT CORPORATION, *et al.*,

Debtors.

Before:

CLARK, *Chief Judge*,
MOORE, *Circuit Judge*, and SMITH, *District Judge*.

Appeal from the United States District Court for the Southern District of New York; Edward J. Dimock, *Judge*.

Appellant, Johnson Fare Box Company, appeals from an order denying the classification of its claim for $43,533.84

(except $42.84) against Surface Transportation Corporation of New York and Third Avenue Transit Corporation (referred to as "debtors") as a six months' priority claim.

Affirmed.

JOSEPH LORENZ, ESQ., New York, N. Y. (Lorenz, Finn & Giardino, John F. X. Finn, Jr., New York, N. Y., on the brief), *for claimant-appellant, Johnson Fare Box Company.*

JOHN A. KISER, ESQ., New York, N. Y. (Saxe, Bacon & O'Shea, Edward D. Burns, New York, N. Y., on the brief), *for Lester T. Doyle, Reorganization Trustee-Appellee.*

PER CURIAM:

Between February 7, 1949 and June 10, 1949 Johnson Fare Box Company (referred to as "Johnson") sold and delivered to the debtors 225 new fare boxes for use on their buses. The purchase prices of these fare boxes totaled $43,533.84. On June 21, 1949 trustees in bankruptcy were appointed for the debtors. Thereafter Johnson filed with the trustees claims for the purchase prices of these fare boxes, and sought a priority over bondholders and general creditors (except those in similar position to Johnson) under the so-called six months' priority rule, i.e., priority given to certain types of debts incurred within the six months preceding the appointment of trustees. These new fare boxes were required because of an increase in fare from five to seven cents. The old boxes would not register the new fare correctly if a nickel and two pennies were deposited because they were designed to record a nickel as one fare and a dime as two fares. Unfortunately, a penny

reacted in the box in the same manner as a dime so that the bus operator was confronted with the problem of trying to prevent the passengers from putting pennies in the box or, if unsuccessful, having more fares recorded and charged against him than passengers carried. Delay, confusion and dissatisfaction resulted.

The reason or motive, however, prompting the debtors to purchase the new boxes does not supply the answer to the legal question as to whether Johnson should be entitled to priority over secured and general creditors.

The so-called six months' priority rule is an invasion of the established contract rights of lienholders. As an invasion the rule should be strictly contained within narrow confines and limited to the purposes which brought it into being. In summary, the rule assumes that debts contracted during a short period, usually fixed at six months before a receivership, for labor, supplies or repairs necessary for a company's operation so redound to the benefit of the lienholders and other creditors that they should receive preferred treatment. On the other hand, new equipment purchased and new construction as distinguished from repairs would not fall within the preferred class. Thus, no matter how advantageous to the efficiency of the debtors' operations a purchase of new buses, for example, might have been, such indebtedness would not be entitled to a priority. As a practical matter, fare boxes were carried on the debtors' books as "Fixed assets operating property" and the debtors used "a ten-year write-off period for all fare box equipment."

As the court below said in a previous decision (*In Re Third Avenue Transit Corporation*, 138 F. Supp. 623; aff'd 2 Cir. 1956, 230 F. 2d 425) it is very difficult to discover "any principle which would account for all of the decisions" and that the only generality obtainable from an examina-

tion of the cases[1] is that "the decision in each one depended upon its special facts."

The conclusion reached by the court below that "the fare boxes were not 'labor, supplies or material' but rather 'new equipment' " was a proper interpretation and application of the rule and the order appealed from is affirmed.

Affirmed.

[1] *Fosdick* v. *Schall*, 99 U. S. 235; *Guaranty Trust Company* v. *Seaboard Airline Ry. Co.*, 14 F. Supp. 555, aff'd sub nom., *Union Switch & Signal Co.* v. *Powell*, 4 Cir., 84 F. 2d 25; *Crane Co.* v. *Fidelity Trust Co.*, 9 Cir., 238 Fed. 693. Compare *Southern Railway Co.* v. *Carnegie Steel Co.*, 176 U. S. 257 (allowing priority for purchases of rails) with *Lackawana & Co.* v. *Farmers Loan & Trust Co.*, 176 U. S. 298 (decided the same day as the *Southern Railway* case but denying priority for purchases of rails). See generally FitzGibbon, The Present Status of the Six Months' Rule, 34 Col. L. Rev. 230.

Appendix B

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 6th day of January one thousand nine hundred and fifty-eight.

Present: HON. CHARLES E. CLARK, Chief Judge,
HON. LEONARD P. MOORE, Circuit Judge,
HON. J. JOSEPH SMITH, District Judge.

In the Matter of

THIRD AVENUE TRANSIT CORPORATION *et al.*,

Debtors-Appellees,

JOHNSON FARE BOX COMPANY,

Claimant-Appellant.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed.

A. DANIEL FUSARO,
Clerk.

Appendix C

SUPREME COURT OF THE UNITED STATES

No. , October Term, 1957

Johnson Fare Box Company, Petitioner, *vs.* Lester T. Doyle, Trustee in Reorganization of Third Avenue Transit Corporation, Debtor; Surface Transporation Corporation of New York, Debtor; Westchester Street Transportation Company, Inc., Debtor, *et al.*	Order extending time to file Petition for Writ of Certiorari.

Upon consideration of the application of counsel for petitioner,

It is ordered that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including June 5, 1958.

/S/ John M. Harlan,
Associate Justice of the
Supreme Court of the United States.

Dated this 2d day of April 1958.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

JOHNSON FARE BOX COMPANY,
Petitioner,
against
LESTER T. DOYLE, Trustee in Reorganization of THIRD AVENUE TRANSIT CORPORATION, Debtor,
SURFACE TRANSPORTATION CORPORATION OF NEW YORK, Debtor,
WESTCHESTER STREET TRANSPORTATION COMPANY, Debtor,
THE WESTCHESTER ELECTRIC RAILROAD COMPANY, Debtor,
THE YONKERS RAILROAD COMPANY, Debtor, and
WARONTAS PRESS, INC., Debtor,
Respondents.

No. 1045

REPLY BRIEF OF JOHNSON FARE BOX CO. IN SUPPORT OF PETITION FOR CERTIORARI

JOSEPH LORENZ,
Counsel for Petitioner,
165 Broadway,

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In The

Supreme Court of the United States

OCTOBER TERM, 1957

JOHNSON FARE BOX COMPANY, Petitioner, *against* LESTER T. DOYLE, Trustee in Reorganization of THIRD AVENUE TRANSIT CORPORATION, Debtor, SURFACE TRANSPORTATION CORPORATION OF NEW YORK, Debtor, WESTCHESTER STREET TRANSPORTATION COMPANY, Debtor, THE WESTCHESTER ELECTRIC RAILROAD COMPANY, Debtor, THE YONKERS RAILROAD COMPANY, Debtor, and WARONTAS PRESS, INC., Debtor, Respondents.	No. 1045

REPLY BRIEF OF JOHNSON FARE BOX CO. IN SUPPORT OF PETITION FOR CERTIORARI

Preliminary Statement

A large portion of the respondents' brief deals with its contention that, as it states, the decision below "is patently correct" (pp. 5, *et seq.*). Although we shall briefly deal herein with its contention in this regard, we

emphasize that the main issue, upon this Application for Certiorari, is our claim that the decision of the Court below is in conflict with the Supreme Court decisions of *Fosdick* v. *Schall*, 99 U. S. 235, and *Southern Railway Co.* v. *Carnegie Steel Co.*, 176 U. S. 257, as well as other decisions, and, further, that there is a conflict of decisions between the Second Circuit and the Fourth Circuit.

We, therefore, deal first with respondents' contention that "there is no conflict with *Fosdick* v. *Schall* and *Southern Railway Co.* v. *Carnegie Steel Co.*" (pp. 9, *et seq.*)

POINT I

In reply to the argument of the trustee that there is no conflict with the decisions of this Court, as made on pages 9-11 of the trustee's brief.

The trustee does not deny that the language of *Fosdick* v. *Schall, supra*, clearly includes within the six months' rule claims relating to "equipment" and "useful improvements". He contends, however, that this language is purely *dictum*, and then makes the remarkable and gratuitous assertion that *it has never since been followed* by this Court. In this connection, he wholly ignores some of *this* Court's leading decisions on this subject. Thus, in *Burnham* v. *Bowen*, 111 U. S. 776, this Court stated:

> "As was said in *Fosdick* v. *Schall*, 99 U. S. 252, 'The income [of a railroad company] out of which the mortgagee is to be paid, is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, *proper equipment and useful improvements.*' " (Emphasis supplied)

Later, in *Southern Railway Co.* v. *Carnegie Steel Co.*, 176 U. S. 257, decided many years after *Fosdick* v. *Schall*, this Court granted priority to a claim for steel rails and

not only relied upon the *Fosdick* case, but at several places in the opinion quoted the very language which refers to "eqipment" and "useful improvements".

The trustee further ignores that this Court was asked to review the decisions in both *Continental Trust Co.* v. *Bonsal*, 72 F. (2d) 975, and *Virginia Passenger & Power Co.* v. *Lane Bros. Co.*, 174 Fed. 513, in the Fourth Circuit, and that certiorari was denied in both instances (293 U. S. 624; 215 U. S. 610).

The trustee, at page 10, attempts to distinguish the decision of this Court in *Southern Railway Co.* v. *Carnegie Steel Co., supra*, by stating that it involved only a small quantity of rails, whereas in the case at bar the claim is allegedly "extraordinary". The fact is that that in *Southern Railway Co.*, where priority was granted by this Court, 4,450 tons of rails had been furnished and the claim, plus interest, aggregated more than $150,000; in the case at bar where, so far, priority has been denied, the claim is only for $43,491. It involved the purchase of 225 fare boxes which, it must be recognized, are physically but a small part of a bus, and their cost in relation to that of the bus was inconsequential. The claim, therefore, is in no sense large or extraordinary considering the extensive transportation system here involved.

POINT II

In reply to the trustee's argument that there is no conflict between the Second and Fourth Circuits.

The trustee contends that the decisions of the Fourth Circuit in *Virginia Passenger & Power Co.* v. *Lane Bros. Co.*, 174 F. 513, and *Continental Trust Co.* v. *W. R. Bonsal & Co.*, 72 F. (2d) 975, relied upon by Johnson to show conflict with the Second Circuit, were "effectively overruled" by the Fourth Circuit in the case of *Union Switch & Signal Co.* v. *Powell*, 84 F. (2d) 25. The fact is that

that decision not only did not reverse the *Virginia* case, but did not even mention it. As to the *Continental* case, far from reversing it, the Court expressly approved it, and stated (p. 26):

> "We think that the action of the lower Court with respect to the first two claims is clearly in accord with the principles which we laid down in Continental Trust Co. v. W. R. Bonsal & Co. (C.C.A. 4th) 72 F. (2d) 975, 981, wherein we carefully reviewed the law and stated the rules applicable in cases of this character."

In the *Union Switch & Signal Co.* case, the Court held that the following items did not come within the six months' rule:

1. Remote control switches, costing over $11,000 per piece, to replace hand switches which cost $1,000 each;
2. Installation of an interlocking plant at a point where there had never been one before;
3. Purchase of signal supplies and construction of additional track, although the tracks were not, in fact, constructed and the equipment was later used for operations.

As to the third group of items, the Court pointed out that even though, because of the abandonment of the plan for additional track, the signal equipment was stored and presumably used for maintenance or operating purposes, that fact "did not change the character of the materials from new construction materials to ordinary and necessary operating supplies".

The Court of Appeals quoted from the opinion of the District Court as follows:

> "The District Court affirmed the finding as to all of these matters saying with respect to the third claim:

'it is essential that the consideration for the debt be a current expense of ordinary operation of the railroad necessarily incurred to keep the railroad a going concern. Materials purchased for *new construction, as occurred here,* do not fall in that class'."

Thus, the *Union Switch & Signal Co.* case in the Fourth Circuit did not expressly or by implication overrule that Court's earlier decisions in *Virginia Passenger & Power Co.* and *Continental Trust Co.*, which remain in clear and sharp conflict with the decision of the Second Circuit in the case at bar and require the review of this Court. As heretofore noted, this Court denied certiorari in the *Virginia* and *Continental* cases at 215 U. S. 610 and 293 U. S. 624.

POINT III

In reply to the trustee's argument that the decision of the Court below is correct.

As heretofore stated, the main question on this application for certiorari is whether or not the decision of the Court below is in conflict with decisions of the Supreme Court and of the Fourth Circuit. However, as the trustee has seen fit to discuss in some detail the merits of the case, we make the following short response thereto. Of course, we argued this matter at some length in our petition.

The Reorganization Trustee (respondent) nowhere disputes that:

(a) the claim of Johnson was a current liability contracted with the expectation of the supplier that it was to be paid out of current earnings;

(b) the boxes were intended for and were used in the ordinary operations of the company, were used in old buses to replace boxes which had become

obsolete with an increase in the fare, and did not involve an extension of the transportation system;

(c) the new boxes became subject to the existing mortgage and enured to the benefit of the mortgagee holders; and

(d) the substitution of new boxes for the old ones was found by the District Court to be "*imperative*".

Nor does he dispute that in August, 1949, shortly after the appointment of the original reorganization trustees, without prior approval of the District Court, they accepted delivery of twenty-five of the boxes formerly ordered by Surface; and then, on September 7, 1949, they petitioned the Court for authority to purchase 449 additional boxes at a cost of $111,060.98. That petition expressly stated that both the trustees and the operating officers of the debtors believed that it was "*necessary*" to obtain the additional boxes (Appendix, page 25a, paragraph numbered 10). The significance of this is fully set out in the Petition for Certiorari herein at pages 14 to 17.

The trustee now suggests (footnote p. 2 of Answering Brief) that the new boxes were merely "desirable" and not really necessary. In the light of the finding of the District Court that the new boxes were "imperative" and in view of the admission of the trustees themselves in their application for permission to purchase additional boxes that such boxes were "necessary", the present suggestion of the trustee should be rejected as clearly without foundation or merit.

At pages 6-7, the trustee quotes at length from an article by FitzGibbon on "The Present Status of the Six Months' Rule", wherein the rule formulated by Cutcheon and urged by the trustee is set forth. It should be observed, however, that FitzGibbon makes the following addi-

tional statement:

> "This excellent statement [the Cutcheon statement] may not be immediately appreciated by one who is told that under it, at the same term of the Supreme Court, a claim for steel rails furnished to one railroad company has been held to be entitled to priority (176 U. S. 257) and, in another railroad receivership, a similar claim was denied priority (176 U. S. 298). The answer lies in the fact that in the second case it was found that there were not present the three following prerequisites which are universally recognized as necessary to establish a right to preference:
>
> (1) That the origin for the claim was a 'current expense' of ordinary operation on the railroad necessarily incurred to keep it a going concern.
>
> (2) That the claim represented a debt contracted with the expectation or intention of the parties that it was to be paid out of the 'current earnings' of the railroad.
>
> (3) That the claim accrued within a reasonably brief time (generally construed to be six months) prior to the appointment of the receiver."

In our Petition we have already demonstrated that these three prerequisites are present in the case at bar.

The above statement by FitzGibbon merits further consideration. It will be noted that he refers to two cases, 176 U. S. 257 and 176 U. S. 298, which respectively are *Southern Railway Co.* v. *Carnegie Steel Co.* and *Lackawanna Iron & Coal Co.* v. *Farmers Loan & Trust Co.* As the report shows, these cases immediately followed one another in 176 U. S. In the *Southern Railway* case a claim for steel rails was held to be entitled to priority and in the case immediately following, another claim for steel rails in a substantially larger amount and which did not

provide for short term credit, was denied priority. In the later case (*Lackawanna*), the rails were delivered "about 16 months before the company's property was put into the hands of a receiver, and 5½ years before the appointment of a receiver in this cause." In the *Lackawanna* case, moreover, collateral security had been given by the raiway to the claimant. The quantity of the rails purchased in the *Lackawanna* case was a fundamental basis in the determination that new construction was involved. Of the utmost significance is the fact that it was the *Southern Railway Company* case, quoted on page 9 of the Petition, in which this Court explicitly included "proper *equipment*" and "*useful improvements*" as coming within the scope of the six months' rule. It is hardly conceivable that this same Court, which on the same day decided the *Lackawanna Iron & Coal Co.* case, should have ignored or overruled its definition made in *Southern Railway Co.* case, which in turn was quoting *Fosdick* v. *Schall*, 99 U. S. 235. Yet it is significant that FitzGibbon, in the article quoted above, obviously relies on both the *Lackawanna* and *Southern Railway* cases, both of which he cites. It is obvious that the very authority upon which the trustee relies recognizes that what comes within the six months' rule depends on the specific facts of each case, and that what might definitely be deemed as repairs or materials and within the rule in a large railway line might properly be deemed reconstruction or new construction in a small one.

The following statement in 2 Gerdes on Corporate Reorganization (p. 1071, par. 673) is most significant. He states in part:

> "Such necessary operating expenses as will be allowed include claims for fuel and power, and other mere incidental *equipment* used in the ordinary course of continuing business, and which would have been paid out of current earnings at the time agreed on if the company had remained in possession.'" (Emphasis supplied)

It will be noted that Gerdes in the passage above quoted uses the phrase, "and other mere *incidental equipment*", as coming within the scope of the six months' rule. This passage clearly shows what the courts mean when they include "equipment" as coming within the rule. They are not referring to extensions of lines or, generally speaking, to basic equipment such as railroad cars, locomotives, etc.; they refer, as Gerdes states, to "incidental equipment." What would be deemed equipment in one case is not equipment in another.

The case of *Rodger Ballast Car Co.* v. *Omaha K.C. & E.R. Co.*, 154 F. 629, cited on page 7 of the trustee's brief, involved the purchase of 32 ballast cars for a railroad employing only 168 miles of railroad. The Court held that this was not a current expense in the ordinary course of business (p. 633). There is no similarity between the purchase of a large number of new cars for a small railroad and the case at bar which involves fare boxes—physically a small part of a bus.

The trustee now argues that the purchase of new boxes by Surface was extraordinary and, therefore, the claim is not entitled to priority. He *ignores his express stipulation* that the new boxes "were intended for and were used in the *ordinary* operations of the Debtor and Surface" (Emphasis supplied) (12a*).

In *Crane* v. *Fidelity Trust Co.*, 238 Fed. 693, cited by the trustee at pages 8-9, the Court granted priority with respect to that portion of the claim which arose within six months of the receivership, but denied it with respect to other claims. The other claims included:

1. Service extensions such as gas equipment for service connection and water equipment for service connections;

---

* Figures in parentheses refer to pages of the printed Appendix to appellant's brief in the United States Court of Appeals.

2. main extensions for water main extensions to different places;

3. Betterments such as hydrant systems, wood gates and water valves;

4. reconstruction of water mains and pipes to replace certain old mains;

5. repairs, miscellaneous items in the way of water equipment.

It is important to note, as the Court stated in the *Crane* case, that the items with respect to which priority was denied were sold "*prior to the time preceding the appointment of a Receiver within which courts of equity have announced that priority claims would accrue*" (p. 698).

POINT IV

The six months' rule is a recognized exception to the "absolute priority" which mortgagees would otherwise enjoy.

In this proceeding, the petitioner Johnson is not invoking any novel doctrine. As the trustee himself concedes, the six months' priority rule is of long standing, having had its origin in the opinion of this Court in *Fosdick* v. *Schall, supra,* in 1879. The principal considerations underlying the rule are that:

(1) "Every railroad mortgagee in accepting his security impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income." (*Southern Railway Co.* v. *Carnegie Steel Co., supra,* at page 274); and

(2) "The maintenance of the road and the prosecution of its business were essential to the preserva-

tion of the security of the bondholders." (*Southern Railway Co.* v. *Carnegie Steel Co., supra* at page 278.)

The case of *Kneeland* v. *American Loan Co.*, 136 U. S. 89, referred to at page 11 of the trustee's answering brief, and the very language quoted in the brief, was considered by this Court in the *Southern Railway Co.* case, but the Court then proceeded to grant priority, recognizing that the claim under consideration came within the six months' rule.

As we have demonstrated in the Petition, the claim in the case at bar likewise falls squarely within the principles laid down for priority under the rule.

CONCLUSION

The petition for a writ of certiorari should be granted.

JOSEPH LORENZ,
Counsel for Petitioner.

June 24, 1958

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

No. 1045

IN THE MATTERS

of

THIRD AVENUE TRANSIT CORPORATION, *et al.*,
Debtors.

JOHNSON FARE BOX COMPANY,
Petitioner,

against

LESTER T. DOYLE, as Trustee in Reorganization, etc.,
Respondent.

BRIEF OF REORGANIZATION TRUSTEE IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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June 19, 1958

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BRIEF OF REORGANIZATION TRUSTEE IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Introductory

Johnson Fare Box Company (hereinafter "Johnson"), seeks a review of a judgment of the Court of Appeals for the Second Circuit, which unanimously affirmed an order of the District Court for the Southern District of New York, Hon. Edward J. Dimock presiding, in proceedings for the reorganization of Third Avenue Transit Corporation and its principal operating subsidiary, Surface Transportation Corporation of New York (hereinafter "Surface"), pursuant to Chapter X of the Bankruptcy Act. The order denied Johnson's claim for priority under the so-called "six months' rule" for the unpaid balance of the purchase price of 225 new fare boxes in the sum of $43,491.

The Question Presented

Did the Court of Appeals and the District Court, on the facts of this case, err in denying priority (over lien holders and other creditors) to the claim of Johnson for the unpaid balance of the purchase price of fare boxes, representing an extraordinary program for the replacement of equipment, under the rule according priority to certain claims for labor, supplies and repairs incurred within six months of the appointment of the reorganization trustee?

Statement

The statement on behalf of petitioner fails to adequately distinguish between those facts which were stipulated (3a-20a) and the speculation of petitioner's counsel.*

The facts are fairly set forth both in the opinion of Judge Dimock (46a-48a) and in the opinion *per curiam*** of the

---

* *E.g.*, referring to difficulties in the operation of buses without efficient fare collection equipment, counsel asserts (p. 5): "This practice opened the door wide to dishonesty and peculation on the part of the bus operators." No such "fact" was stipulated and no such evidence was presented.

As counsel proceeds, his enthusiasm mounts. Entirely without reference to any evidence, counsel refers to impending "early disaster" (p. 17) to "consequent jeopardy of the safety of the traveling public", and asserts that "the *safety of the traveling public* (italics petitioner's) was likewise jeopardized (p. 13)."

It is clear that the acquisition of improved fare collection devices was desirable. It is equally clear that from the institution of the 6¢ fare in September of 1948 and the 7¢ fare in November of 1948 Surface was able to operate with its existing equipment for a considerable period of time. This is obvious from the fact that, although the total of the fare boxes sold by Johnson and borrowed from the City of New York was less than was required for a complete replacement of the fare collection devices, operations did continue without interruption (Exhibit D; 24a-26a).

** Judges Clark, Moore and Smith.

Court of Appeals (250 F. 2d 656; App. A 25-27). The Court of Appeals stated:

> "Between February 7, 1949 and June 10, 1949 Johnson Fare Box Company (referred to as 'Johnson') sold and delivered to the debtors 225 new fare boxes for use on their buses. The purchase prices of these fare boxes totaled $43,533.84. On June 21, 1949 trustees in bankruptcy were appointed for the debtors. Thereafter Johnson filed with the trustees claims for the purchase prices of these fare boxes, and sought a priority over bondholders and general creditors (except those in similar position to Johnson) under the so-called six months' priority rule, i.e., priority given to certain types of debts incurred within the six months preceding the appointment of trustees. These new fare boxes were required because of an increase in fare from five to seven cents. The old boxes would not register the new fare correctly if a nickel and two pennies were deposited because they were designed to record a nickel as one fare and a dime as two fares. Unfortunately, a penny reacted in the box in the same manner as a dime so that the bus operator was confronted with the problem of trying to prevent the passengers from putting pennies in the box or, if unsuccessful, having more fares recorded and charged against him than passengers carried. Delay, confusion and dissatisfaction resulted."

The Opinion of the Court of Appeals

After setting forth the facts, the Court of Appeals continued:

> "The reason or motive, however, prompting the debtors to purchase the new boxes does not supply the answer to the legal question * * *.
>
> The so-called six months' priority rule is an invasion of the established contract rights of lienholders. As an invasion the rule should be strictly contained within narrow confines and limited to the purposes which brought it into being. In summary, the rule assumes that debts contracted during a

short period, usually fixed at six months before a receivership, for labor, supplies or repairs necessary for a company's operation so redound to the benefit of the lienholders and other creditors that they should receive preferred treatment. On the other hand, new equipment purchased and new construction as distinguished from repairs would not fall within the preferred class. Thus, no matter how advantageous to the efficiency of the debtors' operations a purchase of new buses, for example, might have been, such indebtedness would not be entitled to a priority.

* * *

"* * * the only generality obtainable from an examination of the cases* is that 'the decision in each one depended upon its special facts.'

The conclusion reached by the court below that 'the fare boxes were not "labor, supplies or material" but rather "new equipment"' was a proper interpretation and application of the rule and the order appealed from is affirmed." [1]

Argument

(1) The decision denying priority to this claim for the purchase price of an extraordinarily large amount of new equipment is clearly correct and not in conflict with any decisions of this Court, or the controlling decisions of any circuit.

(a) The language from *Fosdick* v. *Schall*, 99 U. S. 235, relied upon by Johnson, is *dictum*** which has not been

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* "*Fosdick* v. *Schall*, 99 U. S. 235; *Guaranty Trust Company* v. *Seaboard Airline Ry. Co.*, 11 F. Supp. 555, aff'd sub nom. *Union Switch & Signal Co.* v. *Powell*, 4 Cir., 84 F. 2d 25; *Crane Co.* v. *Fidelity Trust Co.*, 9 Cir., 238 Fed. 693. Compare *Southern Railway Co.* v. *Carnegie Steel Co.*, 176 U. S. 257 (allowing priority for purchases of rails) with *Lackawanna & Co.* v. *Farmers Loan & Trust Co.*, 176 U. S. 298 (decided the same day as the *Southern Railway* case, but denying priority for purchases of rails). See generally Fitzgibbon, The Present Status of the Six Months' Rule, 34 Col. L. Rev. 239."

** Italics are ours throughout.

followed by this Court in subsequent decisions, and the facts in *Southern Railway Co.* v. *Carnegie Steel Co.*, 176 U. S. 257, do not bear even a nodding acquaintance with the case at bar (*post*, pp. 9-11).

(b) There is no conflict of decisions. While certain early cases in the Fourth Circuit (*Virginia Passenger and Power Co.* v. *Lane Bros. Co.*, 174 F. 513; *Continental Trust Co.* v. *W. R. Bonsal & Co.*, 72 F. 2d 975) are out of harmony with the decisions of the other circuits, those cases were effectively overruled by the Fourth Circuit itself in *Union Switch & Signal Co.* v. *Powell*, 84 F. 2d 25, (affg. *Guaranty Trust Company* v. *Seaboard Airline Ry. Co.*, 14 F. Supp. 555), which the Second Circuit cited and relied on in this case. Hence, there is today no present conflict requiring determination by this Court (*post*, pp. 11-12).

(2) The holding that the six months' priority rule is an invasion of the established contract rights of lienholders, to be contained within narrow confines, is fully in accord with the decisions of this Court establishing the "absolute priority" rule in reorganizations under Chapter X. The application of the rule to the particular facts of a single claim is not a matter of such general importance in the administration of proceedings under Chapter X as to merit the attention of this Court (*post*, pp. 13-15).

I

The decision of the Second Circuit is correct and not in conflict with any decisions of this Court or the controlling decisions of any other circuit.

(1) The decision below is patently correct.

Under the "six months' rule" a creditor of a utility with a claim for labor, supplies or repairs, arising shortly before the receivership, who did not extend long term credit and who relied on the income of the utility, is entitled

to a priority over other unsecured creditors and over lien holders.

This rule has its origin in the opinion of this Court in 1879 in *Fosdick* v. *Schall* (99 U. S. 235). For a period of years prior to that decision there were instances of preferential payments of pre-receivership operating expenses both in the state and lower federal courts, but usually with the concurrence of the lien holders.

The opinion of this Court in *Fosdick* v. *Schall* contained broad dictum (*post* pp 9-10) which provided the basis for assertions of priority for a wide variety of claims. On occasion, these claims were recognized by the lower courts (see *Kneeland* v. *American Loan Co.*, *post* p. 13) with the result that in this field of law some slight judicial support can be found for almost any contention.

In an earlier opinion determining the priority of a number of claims (In re *Third Avenue Transit Corporation*, 138 F. Supp. 623; 625; affd. on opinion below 230 F. 2d 425) Judge Dimock, with characteristic candor, stated:

> "* * * I must first ascertain what that rule is and then apply it. Its ascertainment is not easy. The researches of counsel supplemented by such research as has been at my command have not resulted in the discovery of any principle which would account for all of the decisions or even enough of the decisions so that one might say that there was a principle behind them.
>
> • • •
>
> "It seems to me that there is very general acceptance of a rule which will dispose of all of the questions here presented. That rule is as stated by Franklin W. M. Cutcheon, Esq., as quoted by Fitz-Gibbon [*The Present Status of the Six Months' Rule*, 34 Col. Law Rev. 230, 234-5] as follows:
>
> > '*Debts* contracted by the railroad company within a reasonably short time prior to a receivership, whether under a foreclosure bill or a creditor's bill, that is to say, within a period, usually

fixed at six months * * * *for labor, supplies or material or repairs* necessary for the operation of the railroad as a going concern, * * * *are preferred over the lien of a mortgage* * * *.*

'*Debts* of the railroad company for money loaned, for new construction, for general reconstruction (as distinguished from repairs), for the purchase of land and right of way, for additions and betterments which are not chargeable to operation, *for the purchase of new equipment*, for so-called car rentals payable under equipment trust agreements, for rentals under leases, for guarantees of securities of other corporations and for tort claims *do not fall within the class of preferred claims*, * * *.'

* * *

"The cases bear out the limitation in the rule as above stated to 'labor, supplies or material or repairs.'"

On appeal the learned District Judge was unanimously* affirmed on his opinion (230 F. 2d 425).

Other well considered decisions support the rule as stated by Mr. Cutcheon.

In *Rodger Ballast Car Co.* v. *Omaha K. C. & E. R. Co.* (8 Cir., 154 F. 629), the court supplemented its earlier opinion in *Illinois Trust and Savings Bank* v. *Doud* (8 Cir., 105 F. 123, *post*, pp. 9-10) in which it reviewed with great care the early decisions of this Court with respect to the six months' rule.

Rodger Ballast Car Co. contended that its claim for the unpaid purchase price of ballast cars was entitled to priority. In rejecting this claim the court said:

"For the purposes of this decision the concession is made that *the purchase of the ballast cars was necessary to keep the Eastern Company a going concern* * * * and increased the security of the bond holders secured by the mortgages. But neither the

* Judges Frank, Hincks and Lumbard.

fact that the consideration of a claim preserved and improved the mortgaged property * * * nor the fact that it was indispensable to keep the mortgagor a going concern * * * will give to the claim a preferential equity over the lien of creditors secured by a prior mortgage. [Citations omitted]. There is another indispensable attribute of a preferential claim. It is that its consideration was a current expense of the operation of the mortgagor incurred in the ordinary course of its business.* * *" (p. 632)

* * *

"A current expense incurred in the ordinary course of business within six months prior to a receivership is a usual expense incurred in the customary course of the business of the company. * * * There was no evidence that the company had ever bought such a lot of cars before, or that in the ordinary course of its business it was accustomed to purchase such a lot once in three months or in six months or in any specific number of months, as a part of the current expenses of its operation. On the other hand, *the record demonstrates the facts that the expense* of this purchase *was not a current or a customary, but an unusual expense,* that it was not *incurred* in the ordinary course of the business of the company, but *on an extraordinary occasion to answer an unprecedented demand and to provide for an unparalleled situation.* For this reason, the debt of the railroad company to the appellant for these cars lacks an indispensable element of a preferential claim, and there was no error in the dismissal of the petition." (p 633)

The foregoing applies with particular force to the claim of Johnson. Concededly, the claim of Johnson arose from a program of replacement of all or a very substantial part of the fare boxes used by Surface, not a "current or customary" program, but "*extraordinary*" and "*to provide for an unparalleled situation.*"

In *Crane Co.* v. *Fidelity Trust Co.* (238 Fed. 693, 698) the Court of Appeals for the Ninth Circuit denied priority

for claims for additional equipment and replacement of worn-out equipment, saying:

> "* * * Worn-out equipment, when replaced on an extensive scale, ought not to be classified as repairs, but as reconstruction. Additions to equipment are not current operating charges. Lackawanna Iron & Coal Co. *v.* Farmers' Loan & Trust Co., supra; Central Trust Co. of N. Y. *v.* Colorado, etc., Co. (D. C.) 200 Fed. 85; Toledo, etc., R. R. Co. *v.* Hamilton, 134 U. S. 296, 10 Sup. Ct. 546, 33 L. Ed. 905; International Trust Co. *v.* Townsend, etc., Co., 95 Fed. 850, 37 C. C. A. 396; Reyburn *v.* Consumers' G., F. & L. Co. (C. C.) 29 Fed. 561."

(2) There is no conflict with *Fosdick* v. *Schall* and *Southern Railway Co.* v. *Carnegie Steel Co.*

Counsel, however, shuns mention of these persuasive authorities, (as well as the most recent decision of the Fourth Circuit, *Union Switch & Signal Co.* v. *Powell*, *post* pp. 11-12), all of which are in accord with the instant decision of the Second Circuit, and alleges a "conflict" with the decision of this Court in *Fosdick* v. *Schall* (99 U. S. 235). Counsel extracts from that opinion quotations to the effect that "proper equipment and useful improvements" and "equipment or permanent improvements" are within the six months' rule (p. 9).

Counsel fails to advise that this was *dictum* and that the *holding* of this Court was a *denial* of priority for the purchase price of railroad cars. Moreover, the dictum with respect to "equipment" and "improvements" has never been followed by this Court nor by the Court of Appeals for any of the circuits, other than in the exceptional, and now limited, cases in the Fourth Circuit (*post* pp. 11-12).

The Court of Appeals for the Eighth Circuit, in *Illinois Trust and Savings Bank* v. *Doud*, 105 F. 123, 143, after

quoting the extracts from *Fosdick* v. *Schall*, relied upon by Johnson here, said:

> "But it is an interesting fact that *these remarks*, upon which so many arguments are based for the preference of unsecured to secured creditors in the application of the income and proceeds of mortgaged property, *were obiter dicta, and* that *the Supreme Court has ever since they were delivered been industriously engaged in limiting their terms and restricting their* effect, * * *. *The decision* * * * *was far from the broad proposuion contained in the remarks we have quoted*, and was in no way supported by them."

The other case relied upon by Johnson, (*Southern Railway Co.* v. *Carnegie Steel Co.*, 176 U. S. 257), points up the absence of authority for the granting of priority for a major replacement of equipment. In the *Southern Railway* case, where priority was accorded for the purchase price of some rails, the Court found that the rails purchased were "*a very small quantity.*"

As the Second Circuit noted in the instant case, on the same day as this Court rendered its decision in the *Southern Railway* case it denied priority for the purchases of rails in *Lackawanna & Co.* v. *Farmers' Loan & Trust Co.* (176 U. S. 298). In the latter case this Court found, among other things, that the quantities purchased were "*unusually large*" (p. 317) and "*to be regarded as extraordinary expenditures*" (p. 316).

Obviously the claim of Johnson bears no resemblance whatever to the "very small quantity" of rails, to which this Court gave priority in the *Southern Railway* case.

The Johnson claim is for the unpaid balance of the purchase price of 225 fare boxes representing a replacement (within a very few months) of *almost 25% of all of Surface's fare collection devices.* It is clearly "unusually large" and not "a very small quantity".

Counsel's repeated assertions that the decision below is "directly contrary to the decisions of this Court" (p. 8) and "clearly contrary to the decisions of the Supreme Court of the United States" (p. 18), when contrasted with the actual decisions, leave counsel, at best, asserting a conflict with *obiter dictum* which, of course, is not ground for the granting of certiorari.

(3) There is no conflict with the Fourth Circuit.

Counsel also asserts (p. 18) that the decisions below are "clearly contrary" to the decisions of the Fourth Circuit in *Virginia Passenger & Power Co.* v. *Lane Bros. Co.* (174 F. 513) and *Continental Trust Co.* v. *W. R. Bonsal & Co.* (72 F. 2d 975). What counsel fails to say is that these decisions were effectively overruled by the subsequent decision of that court in *Union Switch & Signal Co.* v. *Powell* (84 F. 2d 25).

The *Virginia Passenger & Power Co.* case, holding that the deepening and widening of a canal in connection with the conversion of a steam electric plant to water power gave rise to a six months' claim, surely cannot be recognized as any authority outside the Fourth Circuit. Indeed it is extremely doubtful that it would be given any weight today even in that circuit.

In the *Continental Trust* case all of the claims related to supplies used in the construction or repair of railroad bridges which the court found were in a dangerous condition. The court said that the test was whether "in view of the magnitude of the business and of the replacement of old by new and better equipment, the operation crosses the line of usual and customary practice and becomes a work of extraordinary character", and concluded that the expenditures "were [not] extraordinary" (p. 981).

In a later case, the same Special Master, who first passed upon the claims considered by the Court of Ap-

peals in the *Continental Trust* case, said that his prior decision was "near the borderline" (*Guaranty Trust Company* v. *Seaboard Airline Ry. Co.*, 14 F. Supp. 555, 564-5). In the last mentioned case the Master and Judge Way denied priority to a claim for new equipment consisting in part of remote control switches which were to replace hand-operated switches. There, substantially as here, it was stipulated that the new equipment was purchased "*to increase the efficiency* of the operation of the railroad; *to speed up the schedules, and to reduce the cost of* operation." Counsel for the claimant urged that the preferential treatment given to the claims arising out of the construction of the new bridges in the *Continental Trust* case was a precedent for such priority for the equipment claims. The Special Master rejected this contention, and wrote:

> "I feel, too, that that claim, while correctly decided, was near the borderline." (p. 565)

Priority was denied to all elements of the equipment claims. The Special Master's conclusions were held to be "clearly correct" by the District Judge. On appeal (*Union Switch & Signal Co.* v. *Powell*, 84 F. 2d 25) the District Judge was affirmed and the Fourth Circuit limited the scope of its prior opinion in the *Continental Trust* case so as to exclude claims for new equipment.

Thus, it appears that there is now no live conflict among the several Circuits. The *Union Switch & Signal Co.* case is the latest expression by the Fourth Circuit. It was cited in the instant case. These decisions, together with those of the Eighth and Ninth Circuits (*ante* pp. 7-9), leave the law in this field well settled and adequately stated. Hence there is no occasion whatever for review by this Court.

II

The decision below is in accord with the decisions of this Court establishing the "absolute priority" rule.

The holding of the court below that the six months' rule is "an invasion of the established contract rights of lienholders", and to "be strictly contained within narrow confines", is wholly in accord with the policy implicit in the rule of "absolute priority", wherein this Court has clearly indicated its concern for the preservation of the rights of creditors generally, and secured creditors particularly, against the claims of junior interests (see *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510; *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106; *Northern Pacific Ry. Co.* v. *Boyd*, 228 U. S. 482).

This Court, long ago, in *Kneeland* v. *American Loan Co.* (136 U. S. 89, 97) had occasion to observe:

> "• • • Because in a few specified and limited cases this court has declared that unsecured claims were entitled to priority over mortgage debts, an idea seems to have obtained that a court appointing a receiver • • • could rightfully burden the mortgaged property for the payment of any unsecured indebtedness. • • • One holding a mortgage debt upon a railroad has the same right to demand and expect of the court respect for his vested and contracted priority as the holder of a mortgage on a farm or lot. • • • It is the exception and not the rule that such priority of liens can be displaced."

An able writer in this field has also observed that "• • • further extensions of the rule must be zealously guarded against if railroads are to rely upon financing through the medium of mortgage bonds. If not, all claims will be paid before the funded debt."•

• FitzGibbon, The Present Status of the Six Months' Rule, 34 Columbia Law Review 230, 245.

Counsel for Johnson, however, asserts that, unless the six months' rule is extended to include claims for equipment, suppliers

> "will withhold their vital credit and insist upon cash. Such a situation would obviously hasten the downfall of many companies whose finances are weak." (p. 23).

If the finances of some companies are so "*weak*" that the displacement of mortgage liens is essential for the payment of their equipment suppliers, it would seem that they are fit subjects for reorganization under Chapter X, with its attendant protection* of the rights of security holders and other creditors. It is very doubtful if the public interest would be served by the extension of a rule which permits corporate managements, presumably representing stockholders, to incur obligations which would displace mortgage liens. In fact, there is considered opinion that the rule itself has undesirable effects.** However, as the rule is limited "within narrow confines" to claims for labor, material and repairs, the potentialities for mischief are small.

CONCLUSION

The decision below is patently correct. There is no conflict with the decisions of this Court or the controlling decisions of any other Courts of Appeals. The decision below is predicated upon the particular facts as to this

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* Judicial supervision; appointment of a disinterested trustee; participation by the Securities and Exchange Commission and creditor groups; notice to creditors and the opportunity to be heard; etc.

** "It is likely that the major effect of the six months' rule has been to enable an inefficient or dishonest management to remain in control long after it otherwise would have been superseded." Weiner, Reorganization Under Section 77 (1933), 33 Col. L. Rev. 834, 850.

claim. No question of general applicability and importance in the administration of Chapter X is presented. The petition should be denied.

June 19, 1958.

Respectfully submitted,

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